

CVS Corporation
1996 Annual Report

A large, rectangular sign with a dark border. The text "CVS" is in a large, bold, sans-serif font, and "pharmacy" is in a smaller, bold, sans-serif font below it.

CVS
pharmacy

A large, rectangular sign with a dark border, tilted slightly to the right. The text "24 HOURS" is in a bold, sans-serif font, and "DRIVE-THRU PHARMACY" is in a larger, bold, sans-serif font below it.

24 HOURS
DRIVE-THRU
PHARMACY

A large, curved banner with a dark background and a light, textured border. The text "Grand Opening!" is in a large, bold, sans-serif font, tilted upwards to the right.

Grand Opening!

Our Mission

**We help people live
longer, healthier, happier lives.**

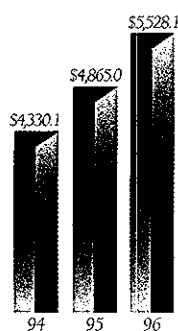
Our Vision

**To become world class at
knowing what our customers value most
and delivering it without exception...
so they can say, "CVS cares about me."**

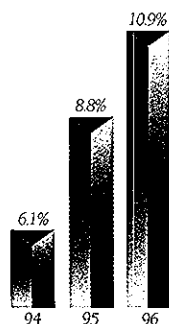
Our Values for Success

**Respect for individuals,
Integrity,
Teamwork,
Sense of urgency,
Openness,
Willingness to embrace change.**

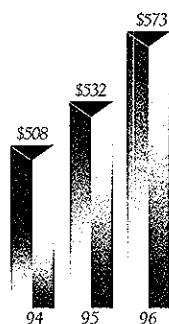
Sales



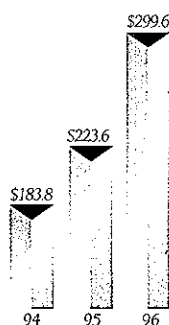
Same Store Sales Increase



Sales Per Retail Square Foot



Operating Profit



"CVS offers big cap investors an excellent combination of quality, financial strength and management aggressiveness."

Robinson-Humphrey, February 18, 1997

Financial and Operating Highlights

In millions, except statistics and per share data	1996	1995	% Change
Results of operations:⁽¹⁾			
Sales	\$5,528.1	\$4,865.0	13.6%
Operating profit ⁽²⁾	299.6	223.6	34.0
Earnings from continuing operations ⁽²⁾⁽³⁾	167.5	100.3	67.0
Earnings per common share from continuing operations ⁽²⁾⁽³⁾	1.44	.79	82.3
Financial position:			
Cash and cash equivalents	\$ 423.9	\$ 129.6	227.1%
Inventories	1,031.4	1,673.0	(38.4)
Working capital	790.8	762.3	3.7
Total assets	2,831.8	3,961.6	(28.5)
Short-term debt	—	52.0	(100.0)
Long-term debt	303.7	327.7	(7.3)
Statistics:			
Sales per retail square foot	\$ 573	\$ 532	7.7%
Same store sales increase	10.9%	8.8%	—
Pharmacy sales as a percentage of total sales	43.9%	42.0%	—
Number of prescriptions filled (in millions)	77.8	71.0	9.6
Inventory turns	4.1	3.9	5.1
Number of stores at year end	1,408	1,366	3.1
Weighted average number of common shares outstanding (in millions)	105.7	105.1	0.6

⁽¹⁾ The results of operations of the former footwear, apparel, and toys and home furnishings segments have been classified as discontinued operations in the consolidated statements of operations for all periods presented.

⁽²⁾ For comparative purposes, operating profit for 1995 excludes the effect of \$165.6 million of restructuring and asset impairment charges and \$494 million of non-recurring operating charges. Earnings from continuing operations and earnings per common share from continuing operations for 1995 exclude the after-tax effect of these charges.

⁽³⁾ For comparative purposes, earnings from continuing operations and earnings per common share from continuing operations in 1996 exclude the after-tax effect of the \$1214 million gain on the sale of securities.

To Our Shareholders

As this report was going to press, we announced a very exciting development in our ongoing plan to position CVS as one of the nation's preeminent growth companies. On February 7, 1997, we announced a definitive agreement to acquire Revco D.S., Inc. in a stock transaction valued at approximately \$2.8 billion.

All of us at CVS are enthusiastic about this combination, which is expected to accelerate our growth and enable us to be even better positioned to excel in our industry and, thereby, maximize shareholder value. Importantly, the transaction meets each of the three criteria for strategic acquisitions we have stated in the past: it is expected to be accretive, before one-time charges; it provides leadership positions in new markets, in particular, the Southeast and Midwest; and it offers significant upside potential by combining the expertise of both companies to further enhance operating performance.

The acquisition is subject to regulatory approvals and a vote of the shareholders of both companies. We hope to complete the transaction by mid-1997.

It is our pleasure to write to you as a shareholder of CVS Corporation. We are a new name in the public markets, yet we are a company with \$5.5 billion in annual revenue, a long and proud history, an established record of leadership in the chain drug industry, and, most important, a strategy to continue our strong growth in the years to come.

We operate in a vibrant industry that will continue to benefit from favorable trends, including an aging American population, greater demand for retail formats that provide easy access and convenience, a consolidating industry environment, discovery of new and more potent drug therapies, and a need for cost-effective healthcare solutions.

CVS' Grand Opening: A New Stock Symbol And A New Beginning

Under its strategic restructuring program, Melville greatly enhanced shareholder value by transforming itself from a diversified retailer with a wide range of specialty retail businesses into an industry-focused retail healthcare company, CVS Corporation. The restructuring involved divesting a significant number of retail businesses through sale, spinoff or initial public offering—all of which was accomplished between November 1995 and December 1996.

We sold Marshalls, Kay-Bee Toys, Wilson's and This End Up; spun off Footstar, Inc. (incorporating Meldisco, Footaction and Thom McAn) to shareholders, and completed an initial public offering of Linens 'n Things. Throughout all these events, we never took our eye off the ball, as evidenced by CVS' record-setting performance in 1996.

On October 16, 1996, along with a number of enthusiastic CVS associates, we marked the transformation of our company by visiting the New York Stock Exchange. We rang the opening bell as we officially began to trade under the "CVS" symbol—marking a new beginning for our company.

Following shareholder approval, Melville's corporate name was officially changed to CVS Corporation on November 20, 1996.

We are very proud of these accomplishments and more confident than ever that we are well-positioned for continued significant growth in the years ahead. Our associates are also very enthusiastic about CVS' future. CVS has achieved an excellent record over its 33-year history, and we are all eager to demonstrate to investors what has made, and will continue to make, CVS such an outstanding vehicle for growth and industry leadership.

Record Sales and Earnings

In fact, 1996 was CVS' best year ever.

Net sales from continuing operations, representing solely the operations of CVS, increased 13.6% to \$5.5 billion from \$4.9 billion in 1995. CVS' same store sales rose an industry-leading 10.9%, with pharmacy same store sales increasing 16.9% and front-store same store sales climbing 6.5%. Since 1992, CVS' sales have grown at a compound annual rate of 11%.

Consolidated net earnings from continuing operations for 1996 increased to \$167.5 million, or \$1.44 per share, excluding a \$0.68 per share gain from the sale of 1.75 million shares of The TJX Companies, Inc. preferred stock. This was a 67% increase over the \$100.3 million, or \$0.79 per share, reported in 1995, excluding the effect of the special charges related to the 1995 restructuring. When compared to other drug chains, our sales per retail square foot of \$573 and operating margins of 6.1% (before the corporate overhead associated with the Melville restructuring) place us among the top performers in our industry.

Strategy to Generate Growth and Increase Shareholder Value

CVS' strong performance is driven by a business strategy that is clearly focused on the customer. Our objective is to know our customers so well that we understand what they value most and deliver it every time.

We execute our service-oriented, customer-focused strategy by building upon four distinct competitive advantages—market leadership, execution at retail, managed care expertise and the use of advanced technology.

These competitive advantages have been the building blocks of CVS' robust growth and have provided an important framework for developing a long-term strategy to achieve continued growth and build shareholder value. This strategy has three main components: driving top-line revenue growth; improving operating efficiencies; and ensuring that CVS achieves appropriate returns on the capital it deploys.

We are confident that we will continue to achieve healthy increases in sales by maintaining a high level of customer service while enhancing the performance of our existing stores, opening new stores in both new and existing markets and pursuing new opportunities in the healthcare arena.

Sales Growth in Existing Stores

In our existing stores, we are making changes to improve our already excellent productivity. Among the most significant are our use of point-of-sale data and our move to a category management approach, which affords us the ability to refine and tailor our merchandise selection market-by-market. In addition, we have placed greater emphasis on building key destination categories—such as greeting cards, film and photofinishing, beauty and cosmetics, convenience foods, private label and seasonal items—and customer counts have already increased as a result.

Our stores are highly appealing, featuring clean and neat spaces that are well-merchandised and easy to shop. In fact, we touch 40% of our fleet each year through a program that calls for 20% of the stores to be remodeled and another 20% to be remerchandised.

Our pharmacy stores fill an average of 1,200 prescriptions per store per week. Growth on the pharmacy side is driven by our focus on customer service and our continued ability to grow in the rapidly expanding managed care arena.

"CVS can be proud of its impressive

Aggressive New Store Program

A key aspect of our growth strategy is accelerating the opening of new stores. In 1996, we opened a total of 98 new stores, including 23 relocations. Beginning in 1997, we plan to accelerate our program for new store openings and relocations. A significant opportunity exists for us to continue to shift our stores from strip shopping centers to freestanding locations, which consistently leads to a 20-25% lift in sales. Currently, about 15% of our store base is freestanding. Almost all new stores will be 10,000 square foot, freestanding and convenient locations with drive-thru pharmacies.

During 1996, we staged a marketing blitz as we entered the Atlanta market with the simultaneous grand-opening of nine stores—a first for CVS. These stores have gotten off to a very strong start, exceeding our initial expectations. We also announced plans to expand, through internal growth or acquisition, in the high-growth southeastern region. This is an area that is highly attractive and presents an excellent opportunity for CVS to increase its presence.

Sharp Focus on Healthcare Opportunities

CVS is committed to being part of an integrated healthcare system that brings together industry participants, such as physicians, pharmaceutical companies, managed care providers and pharmacies, to provide patients with the best possible care at the lowest cost. Our efforts to date have primarily concentrated on two main areas that build upon our strong pharmacy franchise: the operation and expansion of PharmaCare, our "patient benefit management" subsidiary, and the creation of strategic alliances with leaders in healthcare. These are described more fully in the pages that follow.

Focus on Operating Efficiencies and Effective Capital Deployment

In tandem with our efforts to achieve top-line growth, we have taken steps to improve CVS' operating efficiency and reduce costs. The continued growth of lower-margin, third-party paid prescription sales has challenged pharmacy operators to cut costs wherever possible. CVS has risen to this challenge, reducing selling, general and administrative expenses (SG&A) by 172 basis points over the past two years. Our investments in technology have enabled us to continually improve our



Thomas Ryan (left) and Stanley Goldstein

growth in sales and earnings.

And, return on assets
should be the envy
of the retail world.”

Salomon Brothers, August 29, 1996

productivity. Moreover, we expect to further reduce SG&A in the future through the greater use of advanced technology and increased sales leverage.

In addition, it is a priority at CVS to make strategic investments in our business that maximize returns. Over the past three years, we have invested over \$270 million in our operations, while substantially reducing debt. During this period, we have seen our return on net assets increase significantly. Effective capital deployment will continue to be a critical area of focus for CVS, as we seek to make our investment dollars as productive as possible for our shareholders.

Strong Outlook

We are very excited about CVS' future. We have important competitive advantages and a proven strategy for growth. Our healthy financial position, strong consumer franchise and passionate focus on serving

our customers is bolstered by our talented management and employee team that is committed to building our business over the long term and to delivering on what we promise.

Board of Directors

Michael H. Jordan and Harvey Rosenthal will be retiring from the Board of Directors this May. Harvey Rosenthal joined CVS in 1968 and served as President and Chief Executive Officer from 1984 to 1993 and as President of Melville Corporation from 1994 to 1996. He played a major role in positioning CVS as a recognized leader in our industry. Michael Jordan joined our Board in 1985 and his wise counsel was extremely valuable throughout his tenure. We are grateful to them both for their service to the Corporation.

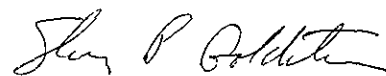
In October of 1996, we welcomed Terrence Murray as a new member of our Board of Directors. Terrence Murray is Chairman, President and Chief Executive Officer of Fleet Financial Group, Inc., a position he has held since 1982. He brings a wide range of business and financial expertise to our Board.

Final Comments

We greatly appreciate the vital contribution each of our 44,000 devoted employees has made in making this past year such a successful one for CVS. We would like to thank our suppliers, our managed care and healthcare partners, and especially the millions of retail customers who shop in our stores every day. We value your business.

Finally, to our shareholders, we are grateful for your support and are committed to pursuing a strategy that will provide for the continued growth and increased value of your investment in CVS. We look forward to reporting on our progress in the years ahead.

Sincerely,



Stanley P. Goldstein
Chairman and Chief Executive Officer



Thomas M. Ryan
Vice Chairman and Chief Operating Officer

February 6, 1997

"We view CVS as an

excellent operator—

the company's flair

for merchandising is

evidenced by its **robust front end comps.**"

Morgan Stanley, December 2, 1996

CVS is known for execution at retail. The well-merchandised front end of the store offers great values to customers.

At CVS, we believe service is the single most important factor in satisfying our customers. As a result, we devote considerable time and attention to making sure we have the right people and the right systems in place to meet our high service standards. We strive to gain more insight to continually develop a better understanding of our customers' needs.

One of the keys to CVS' strong performance is our ability to consistently execute successfully at the retail level. We provide a shopping experience that is convenient, pleasant and satisfying for the customer, which, in turn, results in high productivity for our stores and a growing customer base. CVS' sales per square foot of \$573, among the highest in the industry, is a testament to our success.

Yet, in spite of this healthy performance, we are focused on making the shopping experience even better for our

customers. Among other things, new investments in supply chain technology will enable us to improve our inventory turns and in-stock positions and enhance customer service. In addition, by continually increasing efficiency in our pharmacy departments through our RX2000 advanced pharmacy systems, we enable

our pharmacists to spend more time helping their customers.

CVS stores feature a broad and deep merchandise selection, presented in a well-organized fashion, and are designed to be

warm, inviting and easy to shop. We build on this experience by providing excellent value and superior customer service. Our store sites are well-located and offer easy access. A growing number, currently about 15%, are freestanding sites. As we shift to additional freestanding locations, we experience some shifts in our customer base.



PicturePlace™

Hobart Banks, Manager of the Cheverly, Maryland CVS store, is passionate about customer service. The service orientation of CVS people sets the company apart from its competition. Key to CVS' sales growth is the outstanding performance of destination categories such as greeting cards, over-the-counter products, cosmetics, CVS private label products, seasonal merchandise and, shown here, a "new look" for film and photofinishing featuring a high-impact, high-service presentation to customers.





New convenience food departments in many CVS stores give customers another reason to shop at CVS and reinforce CVS' positioning as a highly convenient place to shop. Customers visit their local CVS store frequently and come to depend on CVS for convenience, value and service. CVS carries more than 1,100 private label items (shown at right). CVS is a brand that customers trust.

With freestanding locations, customers begin to use our stores differently and we tend to see an increase in our "secondary customers", i.e., those that shop at CVS as well as a supermarket or mass merchant. Overall, both our sales and our customer counts increase significantly as a result of the relocation – a winning combination.

CVS' merchandising effort is driven by a highly successful category management approach. It enables us to refine and tailor our product assortments market-by-market based on demographics. As a result, we enhance our value to customers by carrying more of the products they want.



seasonal merchandise and convenience foods. We manage these product areas so as to differentiate CVS in the marketplace and take advantage of the potential each has to offer.

For example, in greeting cards, we have created a card shop, which functions as a "card store within a store" and is generating healthy increases in sales. In beauty and cosmetics, we are installing an upscale

"CVS' front-end same store sales growth has been driven by superior use of POS (point-of-sale) data and

Among our key destination categories are: over-the-counter drugs, CVS' private label products, greeting cards, film and photofinishing, beauty and cosmetics,

beauty counter in as many as 250 of our stores that features more personalized service and higher-end cosmetics, such as Elizabeth Arden, Nailtique, Ultima II and Dermablend. In film and photo-finishing, a rapidly growing category, we have introduced a more updated and exciting look to differentiate the department in our stores. We have also added one-hour photo labs in a number of our stores.

category management."

CREDIT SUISSE FIRST BOSTON, September 9, 1996

One of our fastest-growing categories is the CVS brand of private label products—a brand that is based on quality, value and customer trust. We now offer 1,100 products that account for 11% of our front-end sales. For example, our Gold Emblem line was developed to convey the superior quality and value of CVS' private label edibles. By providing high quality at an excellent price, the CVS brand has grown at an annual rate of over 15%, and we see significant opportunity for new products in the future.

We place an emphasis on attracting friendly and helpful associates to serve customers' needs both in our stores and throughout our organization. We then build on this by providing training and

“CVS operates...a highly appealing and convenient store format with a well-merchandised and easy-to-shop layout, strong pharmacy business, and

excellent customer service.”

William Blair; November 7, 1996

Speed at the checkout and friendly, helpful staff are part of the service that customers value and appreciate.

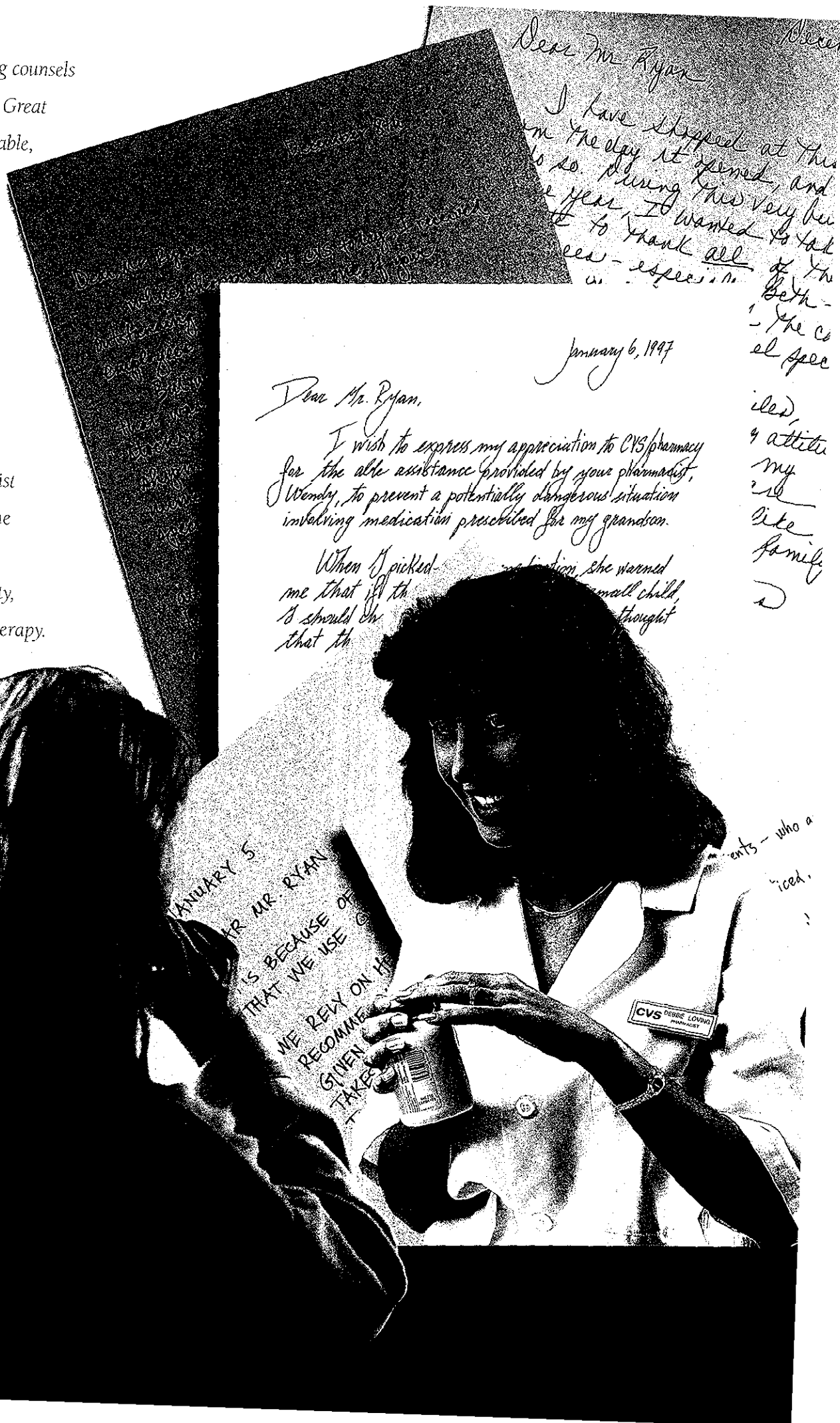
educational programs, as appropriate, and by making sure our people have the tools they need to do their jobs effectively.

We measure our results continuously, so that we can identify and correct problems quickly. Every one of our stores receives a formal customer service evaluation twice per year, based on a mystery shopper program, customer letters and calls, and market research. In addition, feedback received through customer letters and calls is provided on a more informal basis every month.

CVS' priority on customer service extends into the managed care portion of its business as well. In every market, we have a Managed Care Service Team, which is responsible for ensuring that our managed care partners receive a high level of service. These teams have the ability to bring in additional corporate support, as necessary, to meet our partners' needs.



Pharmacist Debbie Loving counsels a customer at the CVS in Great Falls, Virginia. Knowledgeable, accessible, highly professional CVS pharmacists provide counseling and health care information to millions of customers every week. The personal interaction between the customer and the pharmacist is a critical component of the nation's healthcare system and helps ensure high quality, cost-effective prescription therapy. Thousands of unsolicited letters attest to the esteem in which customers hold our pharmacists.



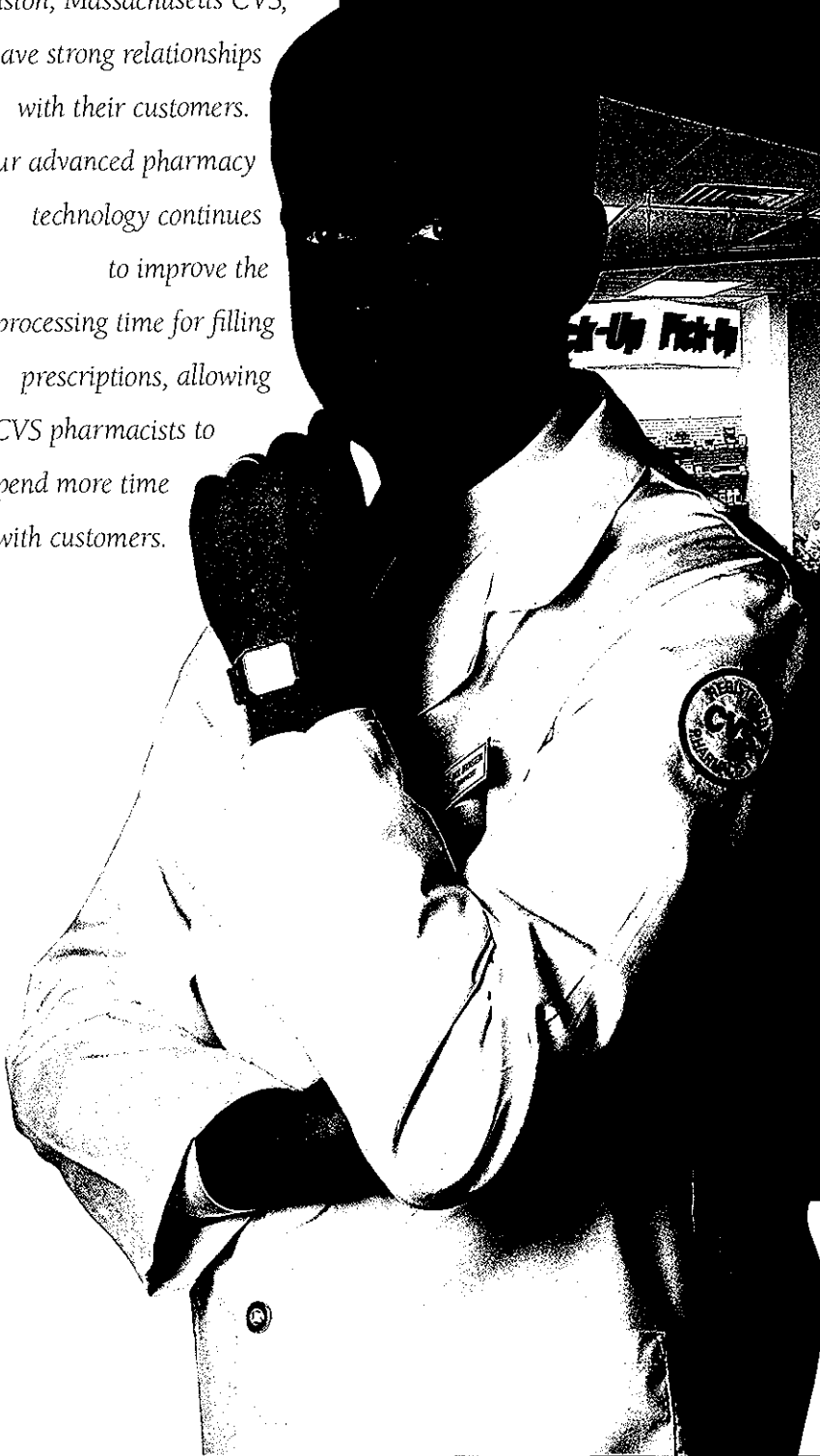
CVS pharmacies feature state-of-the-art computer systems, a layout designed by pharmacists for efficiency and comfort, and accessible pharmacists. Pharmacists like Rick Bronstein, who serves customers at the Easton, Massachusetts CVS, have strong relationships with their customers. Our advanced pharmacy technology continues to improve the processing time for filling prescriptions, allowing CVS pharmacists to spend more time with customers.

Healthcare

Pick-Up Pick-Up

Drop-Off Drop-Off

USE A CREDIT CARD
FOR
EASY PAYMENT



“The U.S. pharmacy market should continue growing steadily due to the aging population and the proliferation of outpatient drug therapy.

CVS' pharmacy departments are among the most productive in the drug retail industry.”

Robinson-Humphrey, February 18, 1997

At CVS, our success at servicing our retail customers and our managed care partners has led to solid growth in our pharmacy business year after year. Our pharmacies fill an average of about 1,200 prescriptions per week, which is significantly higher than the average community pharmacy.

In 1996, pharmacy sales increased 184% to \$2.4 billion, representing 43.9% of our total sales for the year. Pharmacy same store sales rose a robust 16.9% for the year. Our state-of-the-art RX2000 pharmacy computer system speeds the processing time for filling prescriptions, thereby enabling our pharmacy personnel to provide better customer service, such as consulting with customers regarding usage of medications and other important healthcare information.

Throughout the industry we have seen a shift toward payment for prescriptions by third-party providers, which now account for over 80% of CVS' pharmacy business. In the future, we believe growth in pharmacy will be driven by movement within third party, as consumers move from fee-for-service indemnity plans to managed care plans with a preferred provider. That is where our long-standing relationships and experience benefit CVS, as we typically enjoy considerable success. CVS' position in its markets, which provides customers with easy access and convenience, and our experience in providing superior solutions to managed care providers are major factors in attracting third party business.

In addition, our state-of-the-art client server RX2000 pharmacy computer system, coupled with one of the largest data warehouses in the country, enables CVS to provide managed care providers with a level of information unmatched by

competitors. By analyzing this data, CVS and its managed care partners are able to evaluate treatment outcomes with an eye toward improving care and containing costs.

At CVS, a key element of our strategy is to leverage our strong pharmacy franchise. We are making thoughtful investments that build upon the relationships between our pharmacy team and our customers. We continue to improve upon our service dimensions and to manage costs effectively to meet the needs of our customers—at both the retail and managed care level. Above all, we continue to support our store pharmacy personnel to enable them to fulfill their roles as knowledgeable, trusted healthcare professionals and build upon the strong relationships they have with their customers.

Over the past few years, the most prominent change in the healthcare delivery system has been the rapid growth of managed care. CVS' success in serving the managed care marketplace has been driven by our unique, integrated approach that brings together physicians, pharmacists, pharmaceutical companies and managed care providers to deliver patients the best healthcare at the lowest cost.

“More than just a retail dispenser of drugs,

CVS is becoming a more

fully integrated partner

with managed care organizations, providing **innovative solutions** to reduce pharmaceutical costs and improve the quality of healthcare.”

Donaldson, Lufkin & Jenrette, December 12, 1996

PharmaCare, which was formed in 1994, is our prescription benefit management (PBM) subsidiary. Like other leading PBMs, PharmaCare offers managed care providers the full range of prescription benefit management services, including plan design and administration, claims processing, formulary management and generic substitution. We currently manage these services for more than one million people through a preferred national pharmacy network of over 37,500 pharmacies across the country. Unlike other PBMs,



A new interactive voice response system now allows customers the convenience of calling in prescription refills by using a touch-tone telephone.

PharmaCare also focuses on delivering value-added services to our managed care customers through the development of unique, integrated pharmaceutical care solutions to the rising cost of pharmaceutical therapy and quality of care concerns—solutions that benefit our managed care customers, physicians, patients and CVS.

One of the features that sets PharmaCare apart from other prescription benefit management providers is our

proprietary Clinical Information Management System (CIMS). CIMS enables our pharmacists to work more efficiently with physicians by facilitating communication and information-sharing. CIMS enables us to move market share at retail by encouraging physicians to approve lower cost but equally effective drugs, enabling them to comply with their formularies in a

“We believe CVS
to be the drug chain
furthest up the
curve in terms of
its efforts to solve

convenient manner. At the same time,
we are providing a value-added benefit to
our managed care customers through
improving patient care and reducing costs.

CVS is also forging alliances with
pharmaceutical companies and other
healthcare partners to develop innovative

the healthcare equation.”

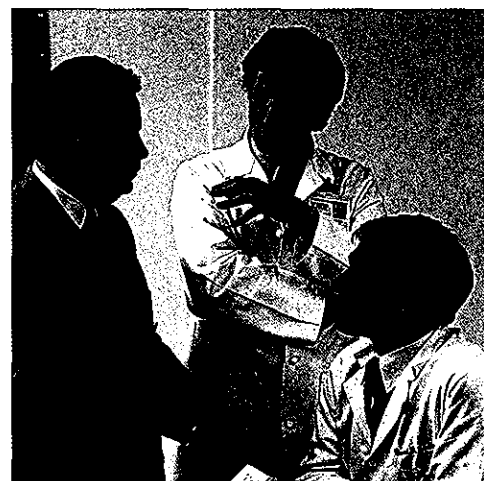
Raymond James, September 11, 1996

healthcare services that will create new
opportunities for revenue and profit
growth. For example, in December 1995,
we formed a joint venture with Pfizer
Health Solutions Inc., a subsidiary of Pfizer
Inc. dedicated to providing a variety of
data analysis and market research services
to Pfizer as well as health plan customers.
The joint venture, called HealthCare Market
Research (HCMR), combines the wealth
of information resident in CVS' pharmacy
data warehouse with Pfizer's experience in
market research and disease management
to provide insights into care management
patterns and improvement opportunities
within specific diseases and patient
populations. By providing information
on physician prescribing, treatment
costs, patient compliance, and other key
parameters, we will support our clients

with valuable outcomes data that can
be used to identify high-quality and
cost-effective treatments.

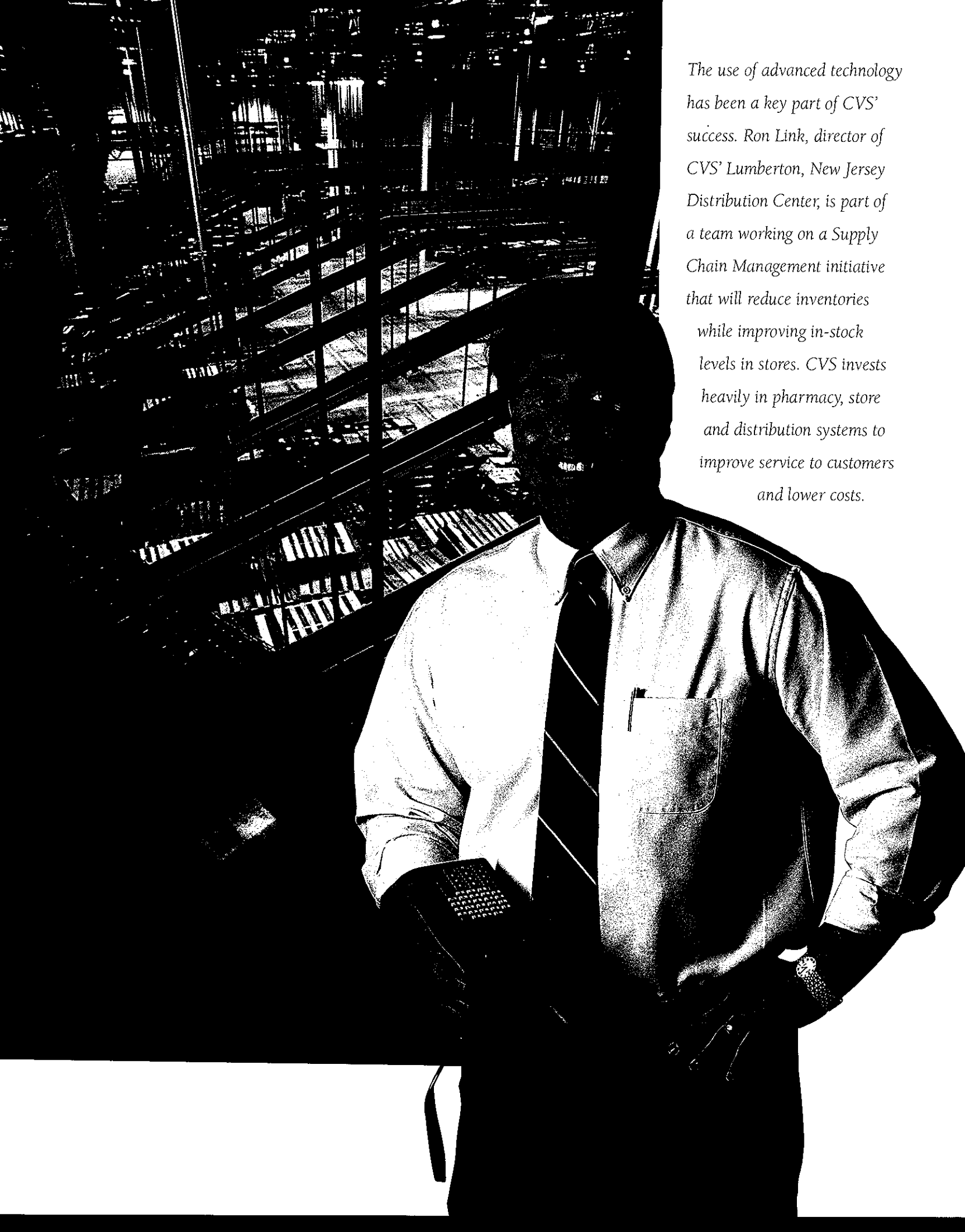
There are many opportunities
for CVS to participate more fully in the
healthcare arena. With our expertise in
pharmacy services, our state-of-the-art
information systems and our value-added,
partnership-focused approach, we are
clearly well-positioned to meet these
challenges.

*Dr. David Schulkin,
Chief Medical Officer (far right),
and Dr. David Bernard,
Senior Medical Director (center),
both of the University of
Pennsylvania Health Systems
(UPHS) and Joseph Botta,
Vice President of Sales for
PharmaCare, are pictured right
reviewing progress on their disease
management partnerships.*





Greg Weisher, left, President of PharmaCare, meets with Tim Birner, Director of Pharmacy Services and Deb Girard, Vice President of Health Services, both of Harvard Pilgrim Health Care (HPHC). PharmaCare has developed a creative risk-sharing program for HPHC, which controls the cost of prescription therapy while improving the quality of patient care.



The use of advanced technology has been a key part of CVS' success. Ron Link, director of CVS' Lumberton, New Jersey Distribution Center, is part of a team working on a Supply Chain Management initiative that will reduce inventories while improving in-stock levels in stores. CVS invests heavily in pharmacy, store and distribution systems to improve service to customers and lower costs.

CVS' technological capabilities are among the most advanced in the chain drug industry and have played a key role in differentiating us from our competition. They enhance our ability to deliver an exceptional level of customer service, while lowering costs and increasing operating efficiency.

We are migrating to a client server-based infrastructure, which provides for rapid and flexible systems development to meet our changing business needs. It enables us to integrate our systems with those of other healthcare providers, including many of our managed care customers.

In our pharmacy business, our state-of-the-art RX2000 system enables CVS pharmacists to manage their prescription filling duties more efficiently, giving them more time to spend with customers. The RX2000 system also facilitates the management of third party healthcare plans and provides a warehouse of pharmacy data that can be analyzed by both CVS and its managed care customers for a variety of

healthcare and business-related applications. During the first half of 1997, we will be installing an enhanced version of RX2000 that will complete the centralization of our pharmacy system, further improving productivity and service. In addition, we are currently rolling out an Interactive Voice Response system that enables customers to conveniently place refill orders by telephone, through keying in the prescription number and the preferred pickup time.

In our front-store business, we have developed an advanced Retail Data Warehouse that enables us to quickly analyze point-of-sale data on a store-by-store basis to develop targeted marketing and merchandising strategies. We have also rolled out a Field Management System that uses POS data to identify areas to improve our operational execution on a store-by-store basis.

In addition, we are in the midst of a major supply chain initiative that is reengineering our entire warehouse and merchandising network, and will enable us



*Tom Sullivan,
Category Manager
for Private Label,
has used technology to
help drive double-digit
growth in sales of
CVS Brand products*

“Technological Innovation

is a focal point for CVS. Its central “RX 2000” client-server system is a cutting-edge mechanism that improves pharmacy information and work flow.”

CREDIT SUISSE FIRST BOSTON, September 9, 1996

to more efficiently and effectively control the flow of merchandise to our stores. The supply chain initiative will have an impact on pricing, promotions and category planning and analysis, enabling us to be an even more effective competitor.

The opening of new stores plays a major role in CVS' continued growth. That is why about 80% of our capital investments are store related. There is significant opportunity to increase our presence in many existing markets, as well as great potential for us to enter new geographic areas.

“CVS' **strong market share** positions provide it with a **competitive advantage** relative to other players.” *Donaldson, Lufkin & Jenrette, November 8, 1996*

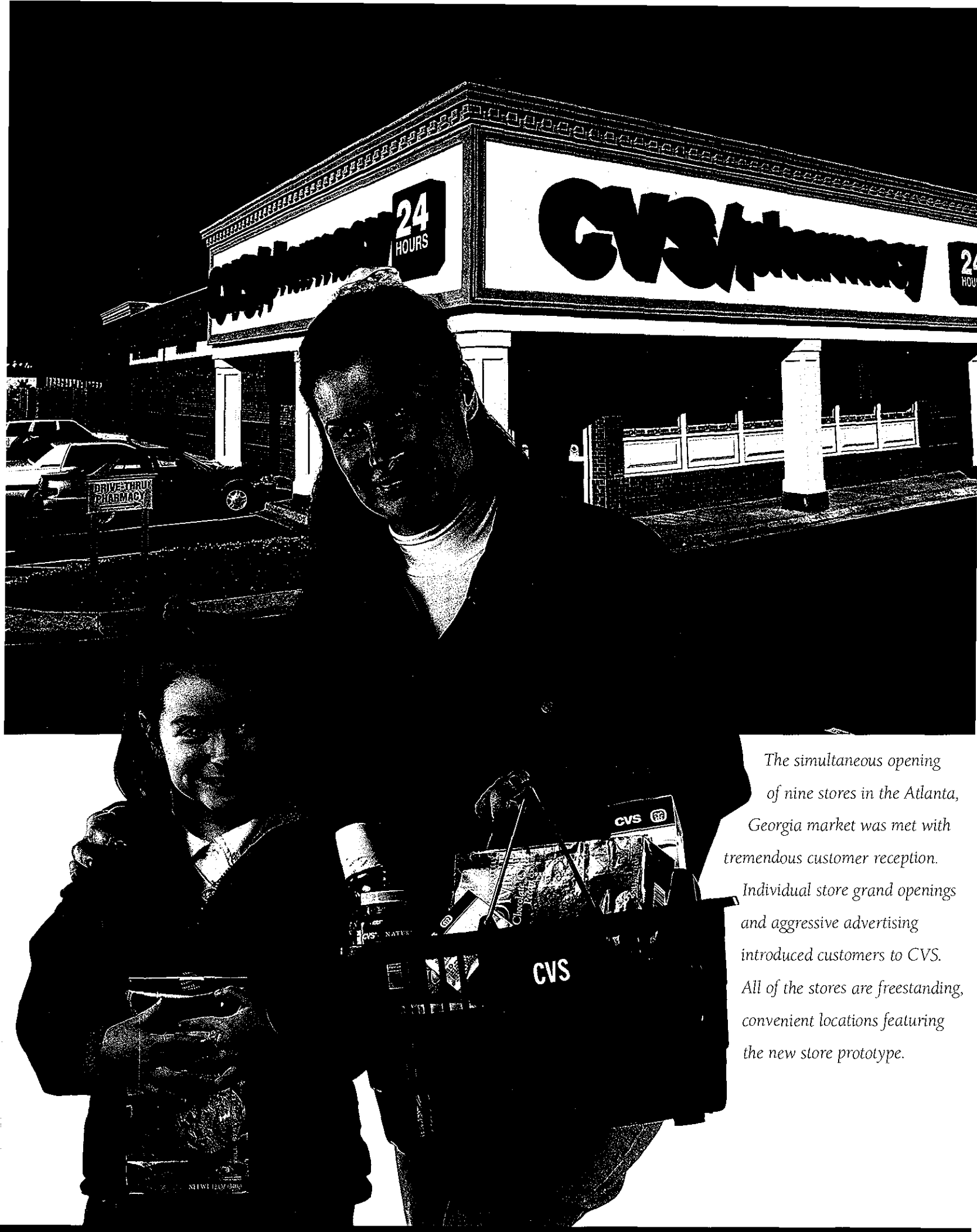
To date, we have primarily concentrated on building a solid base of stores in the Northeast and Mid-Atlantic. We expect to expand our base by entering fast-growing markets in contiguous states

through acquisition opportunities as well as self-development and landlord-built projects. These efforts are complemented by an active store relocation and renovation program that is aimed at making CVS' store base as productive as possible.

As we expand, our objective is to continue to secure strong positions in each of the markets we serve. This provides several important advantages, including an ability to save on advertising and distribution costs. It is also an important consideration for managed care providers who want to provide their members with convenient access to pharmacy services.

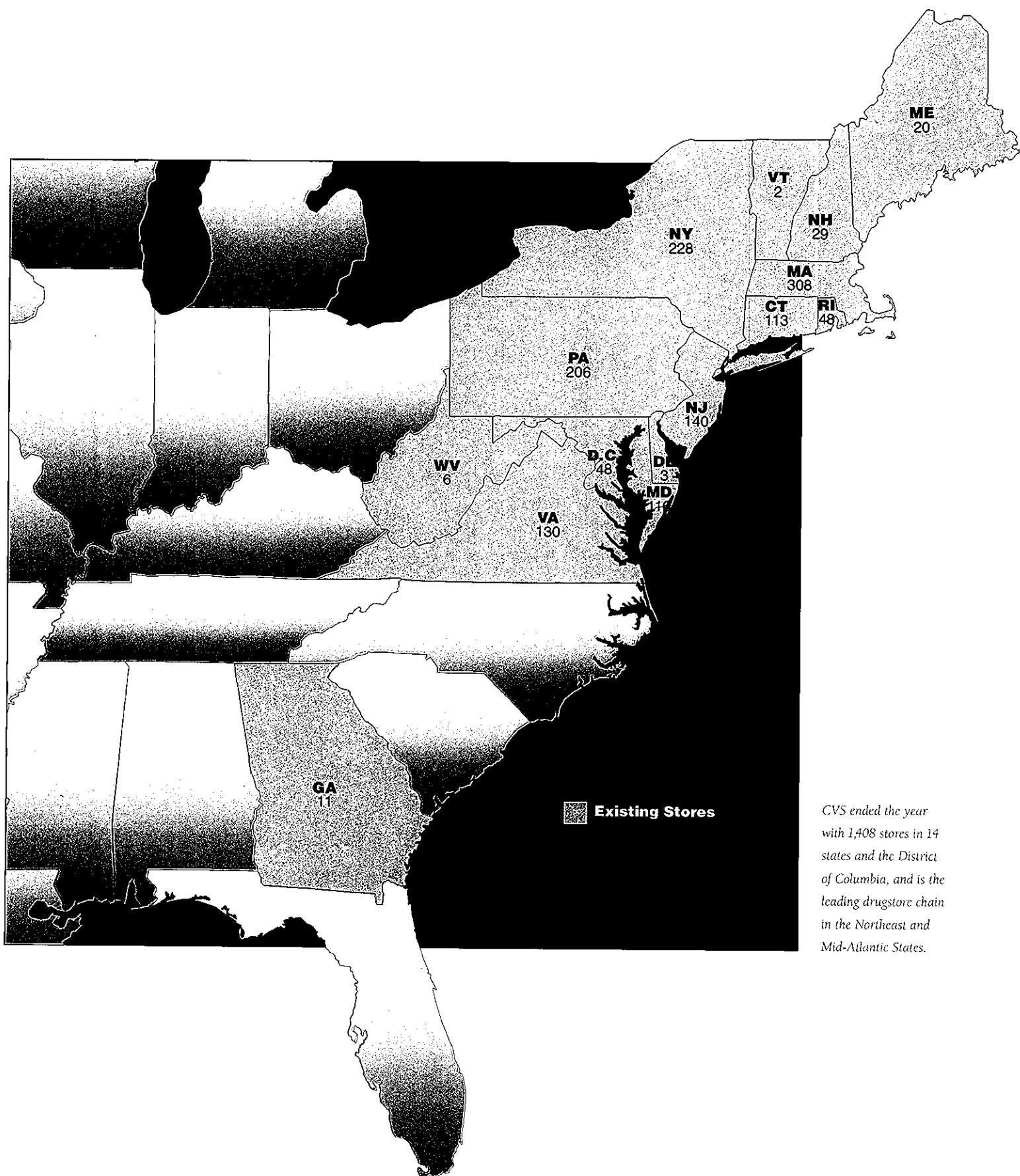
A complete selection of Hallmark greeting cards, creating a “card shop within the store” environment, differentiates CVS from its competitors.





The simultaneous opening of nine stores in the Atlanta, Georgia market was met with tremendous customer reception.

Individual store grand openings and aggressive advertising introduced customers to CVS. All of the stores are freestanding, convenient locations featuring the new store prototype.



CVS ended the year with 1,408 stores in 14 states and the District of Columbia, and is the leading drugstore chain in the Northeast and Mid-Atlantic States.

“We believe there is substantial opportunity for CVS to drive up sales through an

aggressive store development program.”

Morgan Stanley, December 2, 1996

Our new store growth program is being improved and accelerated. Over the past three years, we averaged 88 new and relocated stores per year. During 1996, we opened 98 new stores, including 23 relocations. Beginning in 1997 we will open approximately 150 new stores per year, of which approximately 100 will be

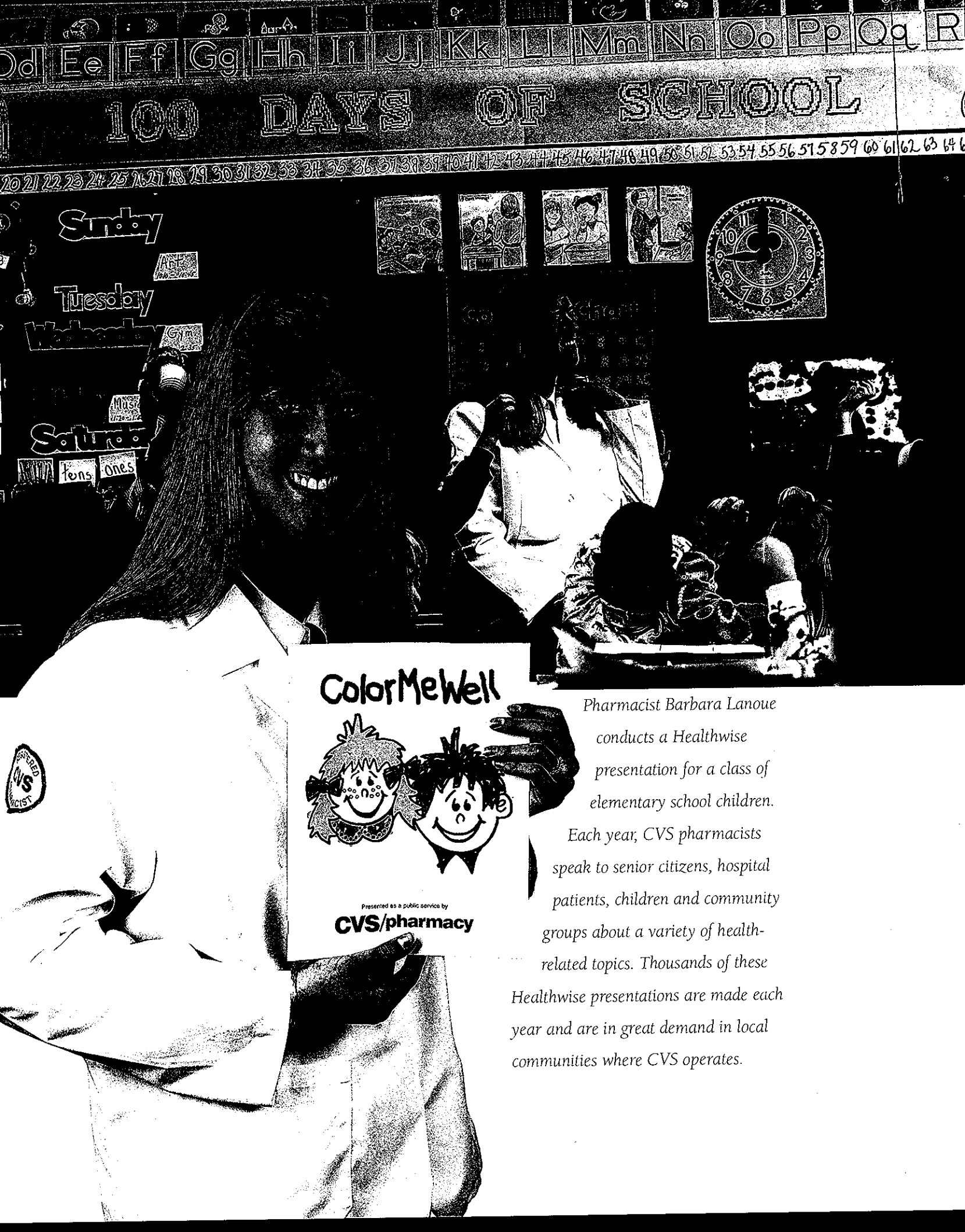
new stores and 50 will be relocations. This will contribute an additional 5% in square footage per year. Our new prototype store is an approximately 10,000 square foot, freestanding and convenient location with a drive-thru pharmacy.

Store relocations are an important aspect of our growth program. As we relocate stores to freestanding or more convenient locations, we are able to achieve a 20-25% increase in sales primarily driven by our front-store categories. Currently only 15% of our fleet is freestanding, which presents us with a significant opportunity for future growth.

In the fourth quarter of 1996, CVS opened its first 11 stores in Atlanta, all of which are performing extremely well. During 1996, we also announced plans to increase our presence—through internal growth or acquisition—in the highly attractive southeastern region, which is experiencing significant growth.

In 1996, in selected stores, CVS rolled out beauty counters that feature upscale products and are staffed by cosmeticians, building on CVS' strength in beauty products and cosmetics.





100 DAYS OF SCHOOL

Sunday

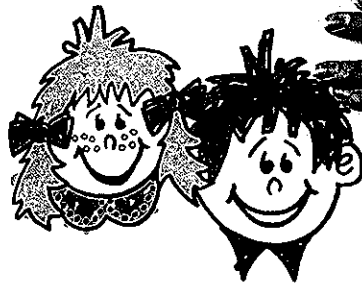
Tuesday

Wednesday

Saturday

Tens Ones

ColorMeWell



Presented as a public service by

CVS/pharmacy

Pharmacist Barbara Lanoue conducts a Healthwise presentation for a class of elementary school children.

Each year, CVS pharmacists speak to senior citizens, hospital patients, children and community groups about a variety of health-related topics. Thousands of these Healthwise presentations are made each year and are in great demand in local communities where CVS operates.

CVS' mission is "to help people live longer, healthier, happier lives."

One of the many ways we do this is by making our stores a community resource. We also support more than 1,100 programs and organizations that aim to improve the quality of life in the communities in which CVS operates.

Through our Healthwise program, CVS pharmacists make thousands of presentations annually to seniors, school-age children, healthcare organizations and community groups to help educate communities about healthcare issues and promote a more proactive approach to maintaining good health.

To further support our communities, CVS has specially equipped CVS Samaritan Vans that patrol limited access highways in six major cities helping motorists whose cars have broken down. All CVS Samaritans are Emergency Medical Technicians who are able to respond to medical emergencies, if necessary.



CVS Samaritan Vans help stranded motorists on the highways. The services of the CVS Samaritans, who also provide traffic updates to local radio stations, are free to the public.

In many parts of the Northeast and Mid-Atlantic, CVS provides Innovations Grants to support the efforts of public school teachers and administrators developing innovative approaches to learning. CVS is also involved in an effort to create and sustain a statewide network of Rhode Island educators committed to systemic school improvement. Additionally, we work in conjunction with a Boston high school to provide an alternative curriculum for inner city students at risk of dropping out of school.

Among the many other examples of our community involvement, CVS sponsored the PGA TOUR event held in Sutton, Massachusetts which raised

Through our **Healthwise** program, CVS pharmacists make thousands of presentations annually to promote a more proactive approach to **maintaining good health.**

monies for the Rhode Island Breast Cancer Coalition and the Make-A-Wish Foundation. We also continue to provide support for AIDS research in many of our communities.

EXIT
DRIVE-THRU/Pharmacy

Pharmacy Pick-up / Drop-off

Pharmacy Pick-up / Drop-off

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Strategic Restructuring Program

The 1995 Plan

On October 23, 1995 (the "1995 Measurement Date"), the Board of Directors of CVS Corporation ("CVS" or the "Company") approved a comprehensive restructuring plan that was the product of a strategic review initiated in 1994. The restructuring plan included, among other things, (i) the continued operation of CVS (which includes CVS, and initially the Linens 'n Things and Bob's divisions), (ii) the disposal of the Marshalls, Kay-Bee Toys, Wilsons and This End Up divisions (collectively, the "Dispositions"), (iii) the spin-off of Footstar, Inc. ("Footstar"), which includes the Meldisco, Footaction and Thom McAn divisions, and (iv) the elimination of certain corporate overhead costs (the "Cost Reduction Program").

In connection with the approval of the 1995 Plan, the Company recorded a pre-tax charge of \$872.0 million in the fourth quarter of 1995 (the "1995 Charge") and discontinued the footwear segment in accordance with Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations—Reporting the effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." As a result of the 1996 Plan discussed below, the apparel segment and toys and home furnishings segment were also discontinued. Accordingly, the portion of the 1995 Charge that pertains to these segments, \$711.4 million, is reflected as a component of discontinued operations, and the remainder, \$160.6 million, is included in continuing operations. The amount recorded in continuing operations primarily includes costs associated with (i) exiting certain geographic markets, (ii) closing duplicate warehouse facilities and (iii) closing Melville's Corporate Headquarters. These costs primarily include asset write-offs, closed store and warehouse lease liabilities and employee severance. Management determined the amount of (i) asset write-offs by comparing the carrying value of the assets to be disposed of to the anticipated proceeds, (ii) closed store and warehouse lease liabilities by calculating the present value of the future minimum lease payments and (iii) employee severance based on an employee's compensation and years of service with the Company. The Company applied the provisions of EITF 94-3 to determine the appropriate accounting treatment for these charges.

Asset write-offs included in the 1995 Charge totaled \$659.7 million. The balance of the charge, \$212.3 million, will require cash outlays of which \$85.7 million had been incurred as of

December 31, 1996. The remaining cash outlays are expected to be incurred primarily in 1997.

In connection with various components of the 1995 Plan, positions for approximately 1,200 store employees and 400 administrative employees have been eliminated.

At December 31, 1996, the 1995 Plan had been completed without significant changes to the Board approved plan. As a result, the Company expects that earnings from continuing operations before income taxes will improve by approximately \$38 million on an annual basis (projected 1997 versus 1995) primarily due to the elimination of certain corporate overhead costs.

The 1996 Plan

On May 29, 1996 (the "1996 Measurement Date"), the Board of Directors approved further refinements to the restructuring plan. The refinements included (i) a formal plan to separate the Linens 'n Things and Bob's divisions from CVS and (ii) a formal plan to convert 80 to 100 of Thom McAn's stores to the Footaction store format and to exit the Thom McAn business by mid-1997.

In connection with the approval of the 1996 Plan, the Company recorded, as a component of discontinued operations, a pre-tax charge of \$235.0 million during the second quarter of 1996 (the "1996 Charge"), substantially all of which related to asset write-offs that will not require net cash outlays. As a result of adopting the plan to separate the Linens 'n Things and Bob's divisions from CVS, the apparel and toys and home furnishings segments were discontinued in accordance with APB Opinion No. 30.

The Company expects that the 1996 Plan will be completed during 1997 without significant changes to the Board approved plan.

The asset write-offs of \$659.7 million and \$235.0 million included in the 1995 Charge and 1996 Charge, respectively, primarily relate to the write-down of the operating divisions to be disposed of to estimated fair value. The significant judgment included in the above write-offs relates to the estimation of fair value for each division. These estimates were prepared by independent third parties.

The Disposals

On November 17, 1995, the Company completed the sale of the Marshalls division to The TJX Companies, Inc. for total proceeds of approximately \$600 million.

On May 4, 1996, the Company completed the sale of the Kay-Bee Toys division to Consolidated Stores Corporation for total proceeds of approximately \$285.7 million.

On May 25, 1996, the Company completed the sale of the Wilsons division to an investor group led by Wilsons' management for total proceeds of approximately \$69.7 million.

On May 31, 1996, the Company completed the sale of the This End Up division to an investor group for approximately \$18.2 million.

On October 12, 1996, the Company completed the spin-off of Footstar by distributing 100% of the shares of Footstar common stock held by CVS to its shareholders of record as of the close of business on October 2, 1996 (the "Footstar Distribution"). See Note 20 for further information about the Footstar Distribution.

On December 2, 1996, the Company completed the initial public offering of 67.5% of Linens 'n Things, Inc. (the "Linens IPO") for net proceeds of approximately \$189.4 million.

The gain and losses that resulted from the above disposals are reflected in the "Discontinued Operations" section of the Consolidated Statements of Operations. The 1996 Charge includes approximately \$47 million related to finalizing certain disposals accrued for in the 1995 Charge. The Company has no continuing involvement with the divested operations.

Other Events

On October 16, 1996, the Company's trading symbol on the New York Stock Exchange was changed to "CVS" from "MES."

On November 20, 1996, the Company officially changed its name to CVS Corporation from Melville Corporation.

See Note 2 to the consolidated financial statements for further information about the Company's strategic restructuring program.

Agreement to Acquire Revco D.S., Inc.

On February 6, 1997, CVS signed a definitive merger agreement to acquire Revco D.S., Inc. ("Revco") in a stock-for-stock merger valued at approximately \$2.8 billion. CVS will also assume approximately \$900 million of existing Revco debt as part of this transaction.

The combination of CVS and Revco, which has been approved by the Boards of Directors of both companies, will bring together two of the leading companies in the chain-drug industry

to create the nation's largest chain drugstore company based on store count, with approximately 4,000 locations in 24 states and the District of Columbia. The combination will bring the combined company into high-growth, contiguous markets in the Northeast, Mid-Atlantic, Southeast and Midwest regions; and the combined enterprise is expected to rank second in annual retail drugstore revenues in 1997.

Under the terms of the merger agreement, CVS will combine with Revco in an exchange of stock that is expected to qualify for treatment as a pooling of interests transaction, tax free to Revco shareholders. If the merger is completed, for each share of Revco common stock held, Revco shareholders will receive the sum of (i) 0.4692 shares of CVS common stock and (ii) the number of shares of CVS common stock equal to the quotient obtained by dividing \$20 by the average closing price of CVS common stock during ten trading days randomly selected out of the twenty trading days ending on the fifth trading day preceding the closing date (collectively, the "Exchange Ratio"), provided that, under no circumstances will the Exchange Ratio exceed 1.0097 or be less than 0.8837.

The transaction is subject to approval by the shareholders of both companies, expiration of the applicable waiting period under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended, and certain other customary closing conditions. If all the closing conditions have been met, it is expected that the transaction will be completed by mid-year 1997.

Revised Dividend

On January 10, 1996, the Board of Directors approved a reduction in the Company's quarterly dividend from \$.38 per share to \$.11 per share (the "Revised Dividend"). Management believes that the Revised Dividend is consistent with chain-drug industry practice and the Company's anticipated capital requirements.

Results of Operations

As a result of the Company's strategic restructuring plan, the results of operations of the former footwear segment, apparel segment and toys and home furnishings segment have been classified as discontinued operations in the accompanying consolidated statements of operations for all periods presented. The following management discussion, therefore, focuses primarily on continuing operations.

Net sales increased 13.6% to \$5.5 billion in 1996, compared to increases of 12.4% in 1995 and 9.7% in 1994. The increase in net sales resulted from strong performances in both the front store (which increased \$262.3 million or 9.3% from 1995 to 1996, compared to an increase of \$241.0 million or 9.3% from 1994 to 1995) and pharmacy (which increased \$376.0 million or 184% from 1995 to 1996, compared to an increase of \$294.5 million or 16.9% from 1994 to 1995). The growth in front store sales was primarily driven by increases in greeting cards, film and photofinishing, upscale beauty and cosmetics, convenience foods, private label products and seasonal merchandise. Growth in pharmacy sales was primarily driven by (i) increased penetration into managed care markets, (ii) the purchase of prescription files from independent pharmacies and (iii) favorable trends, including an aging American population, greater demand for retail formats that provide easy access and convenience, discovery of new drug therapies and a need for cost-effective healthcare solutions.

Same store sales, consisting of sales from stores that have been open for more than one year, rose 10.9% in 1996, compared to increases of 8.8% in 1995 and 6.1% in 1994. Pharmacy same store sales grew 16.9% in 1996, compared to 13.9% in 1995 and 11.5% in 1994. Pharmacy sales were 43.9% of total sales in 1996, compared to 42.0% in 1995 and 40.4% in 1994. Third party prescription sales were 81.8% of pharmacy sales in 1996, compared to 76.1% in 1995 and 69.1% in 1994.

Gross margin as a percentage of net sales was 28.04% in 1996, compared to 27.92% in 1995 and 28.68% in 1994. The 12 basis point improvement as a percentage of net sales in 1996 was primarily due to sales increases in the following higher gross margin categories: greeting cards, film and photofinishing, upscale beauty and cosmetics, convenience foods, private label products and seasonal merchandise. The benefit realized from the expansion of these categories in 1996 was offset partially by expected increases in lower gross margin third party prescription sales and increases in pharmacy sales as a percentage of total sales (collectively, the "Pharmacy Trends"). The 76 basis point decrease in gross margin as a percentage of net sales in 1995 is primarily due to the Pharmacy Trends.

Selling, general and administrative expenses were 21.24% of net sales in 1996, compared to 22.88% in 1995 and 22.96% in 1994. When comparing 1996 to 1995, it is important to note that \$494 million of non-recurring operating charges were recorded in the fourth quarter of 1995. These charges primarily included

initial start-up costs or asset write-offs associated with the Company (i) changing its policy from capitalizing internally developed software costs to expensing the costs as incurred, (ii) outsourcing certain technology functions and (iii) retaining certain employees at Melville's Corporate Headquarters until their respective job functions were transitioned to CVS. Excluding the effect of these charges, comparable selling, general and administrative expenses were 21.87% of net sales in 1995. The comparable 63 and 109 basis point improvements in 1996 and 1995, respectively, were primarily due to (i) the benefit derived from sales in our existing store base growing at a faster rate than operating costs, (ii) the Cost Reduction Program, which included closing Melville's Corporate Headquarters and (iii) the benefits derived from key technology investments such as our RX 2000 Pharmacy System, Interactive Voice Response System for prescription refills, Pharmacy Data Warehouse, Point-of-Sale System, Retail Data Warehouse and Field Management System. These systems have collectively allowed the Company to reduce the labor costs associated with filling prescriptions, managing third party healthcare plans, managing promotional events and scheduling employees.

Depreciation and amortization expense as a percentage of net sales was 1.38% in 1996, compared to 1.46% in 1995 and 1.47% in 1994. The eight basis point improvement in 1996 was primarily due to the write-off of certain corporate assets as part of the Company's strategic restructuring plan.

Operating profit for 1996 increased to \$299.6 million from \$8.6 million in 1995. When comparing 1996 to 1995, it is important to note that \$165.6 million of restructuring and asset impairment charges and \$494 million of non-recurring operating charges included in selling, general and administrative expenses, were recorded in 1995 (collectively, the "Special Charges"). Excluding the effect of the Special Charges, comparable operating profit increased 34.0% in 1996.

Comparable operating profit as a percentage of net sales was 5.42% in 1996, compared to 4.60% in 1995 and 4.24% in 1994. The 82 basis point improvement in operating profit as a percentage of net sales in 1996 was primarily due to (i) leveraging sales growth, (ii) improving gross margin as a percentage of net sales, (iii) the benefits derived from key technology investments, (iv) controlling ongoing fixed costs and (v) the Cost Reduction Program. The 36 basis point improvement in 1995 was primarily due to controlling ongoing fixed costs, offset partially by a decrease in gross margin as a percentage of net sales.

During 1996, the Company completed the sale of 1.75 million shares of The TJX Companies, Inc. Series D and Series E preferred stock (the "TJX Securities") for \$296.4 million (the "TJX Preferred Sales"). These transactions resulted in a pre-tax gain of \$121.4 million (the "TJX Gain"). The Company originally received the TJX Securities as a portion of the proceeds from the sale of the Marshalls division.

During 1996, the Company recognized dividend income of approximately \$5.6 million on the TJX Securities.

Interest expense totaled \$30.7 million in 1996, compared to \$53.9 million in 1995 and \$31.8 million in 1994. The decrease in interest expense in 1996 was primarily due to a \$57.37 million reduction in average daily short-term borrowings, offset partially by higher average daily short-term borrowing rates. The decrease in average daily short-term borrowings in 1996 was primarily due to the favorable impact of (i) the Dispositions; (ii) the Linens IPO, (iii) the TJX Preferred Sales and (iv) cash provided by continuing operations. The \$22.1 million increase in interest expense in 1995 was primarily due to a \$188.7 million increase in average daily short-term borrowings that resulted largely from operating losses and disappointing cash flow results at certain former divisions.

Interest income totaled \$7.5 million in 1996, compared to \$4 million in 1995 and \$1.0 million in 1994. The increase in interest income in 1996 was primarily due to interest earned on notes receivable that were received as a portion of the proceeds from certain of the Dispositions and to an increase in available cash that resulted from (i) the Dispositions, (ii) the Linens IPO, (iii) the TJX Preferred Sales and (iv) cash provided by continuing operations. The decrease in interest income in 1995 was primarily due to a decrease in available cash that resulted from operating losses and disappointing cash flow results at certain former divisions.

The Company's effective income tax rate for continuing operations was 40.6% in 1996, compared to 41.0% in 1995 and 1994. The 40 basis point decrease in 1996 was primarily due to the TJX Gain.

Earnings from continuing operations increased to \$239.6 million in 1996 from a net loss of \$26.5 million in 1995. Excluding the TJX Gain in 1996, earnings from continuing operations were \$167.5 million, or \$1.44 per share. Excluding the Special Charges in 1995, earnings from continuing operations were \$100.3 million, or \$.79 per share. In 1994, earnings from continuing operations were \$90.3 million, or \$.70 per share.

Discontinued operations consists of (i) (loss) earnings from operations, net of income tax benefit (provision), which represents the earnings or loss for a segment from the date of the earliest period presented to the respective segment's measurement date, and (ii) estimated loss on disposal, net of income tax benefit, which represents the estimated loss on disposal plus the segment's operating income or loss during the phase-out period. The phase-out period is defined as the period from the segment's measurement date to the date of disposal. The estimated loss on disposal was based on the difference between the carrying value of the segment affected and the estimated proceeds the Company expects to realize upon disposition. The estimated proceeds were the result of analyses prepared by independent third parties.

Net earnings including (i) continuing operations which includes the TJX Gain and (ii) discontinued operations which includes an after-tax restructuring charge of \$148.0 million, or \$1.40 per share, were \$75.4 million, or \$.57 per share in 1996. This compares to a net loss of \$65.71 million, or \$.641 per share in 1995 and net earnings of \$307.5 million, or \$2.75 per share in 1994. The decrease in net earnings in 1995 was primarily due to the Special Charges.

As of December 31, 1996, CVS operated 1,408 stores in 14 states and the District of Columbia, an increase of 3.1% from 1,366 stores as of December 31, 1995.

Liquidity and Capital Resources

The following discussion regarding liquidity and capital resources should be read in conjunction with the Company's consolidated balance sheets as of December 31, 1996 and 1995, and the related consolidated statements of operations and cash flows for each of the years in the three-year period ended December 31, 1996.

The Company has four primary sources of liquidity: (i) cash and cash equivalents, (ii) cash provided by operations, (iii) commercial paper and (iv) bank loan participation notes. The Company's commercial paper program is supported by a \$320 million, five-year unsecured revolving credit facility (the "Credit Facility"). The Credit Facility contains customary financial and operating covenants. Management believes that the restrictions contained in these covenants do not materially affect the Company's financial flexibility.

The Company issues commercial paper to finance, in part, its seasonal inventory requirements and capital expenditures. Borrowing levels throughout the year are typically higher than those reflected in the Company's year-end balance sheet. Management believes that the Company's cash on hand and cash provided by operations, together with its ability to secure short-term financing through commercial paper and bank loan participation notes, will be sufficient to cover its working capital, capital expenditure and debt service requirements.

Following is a summary of the Company's liquidity as of and for the years ended December 31:

<i>In millions, except ratios</i>	1996	1995	1994
Cash and cash equivalents	\$ 423.9	\$ 129.6	\$ 117.0
Net cash provided by (used in)			
investing activities	501.8	23.8	(371.1)
Net cash used in			
financing activities	(341.2)	(356.7)	(91.3)
Average daily short-term			
borrowings	182.4	756.1	567.4
Maximum short-term borrowings	543.1	1,196.2	948.5
Short-term borrowings at year-end	—	52.0	200.0
Net interest expense	23.2	53.5	30.8
Ratios:			
Net investments			
(long-term obligations)			
to total capitalization ⁽¹⁾	19.3%	(1.2)%	(7.9)%
Inventory turns—			
continuing operations	4.10	3.93	3.69
Current ratio	1.6	1.4	1.6

⁽¹⁾ The ratio of net investments (long-term obligations) to total capitalization was calculated by dividing (i) long-term debt less the sum of cash and cash equivalents plus investments by (ii) the sum of long-term debt plus total shareholders' equity.

Cash and cash equivalents increased \$294.3 million to \$423.9 million in 1996 primarily due to the favorable impact of (i) the Dispositions, (ii) the Linens IPO, (iii) the TJX Preferred Sales, (iv) the Revised Dividend and (v) cash provided by continuing operations. The cash flow benefit derived from these sources was offset partially by the settlement of certain obligations that were established as part of the Company's strategic restructuring plan and by certain contributions made in connection with the Footstar Distribution and the Linens IPO. Cash and cash equivalents did not change materially in 1995 from 1994.

Net cash provided by operating activities decreased \$211.8 million to \$133.7 million in 1996 primarily due to the timing of (i) the Dispositions, (ii) the Footstar Distribution, (iii) the Linens IPO and (iv) the settlement of certain obligations that were established as part of the strategic restructuring plan. Net cash provided by operating activities decreased \$152.9 million to \$345.5 million from 1994 to 1995 primarily due to the timing of the sale of the Marshalls division and operating losses and disappointing cash flow results at certain former divisions.

Net cash provided by investing activities increased \$478.0 million to \$501.8 in 1996 primarily due to (i) the Dispositions other than the sale of the Marshalls division, (ii) the Linens IPO, and (iii) the TJX Preferred Sales. Net cash provided by investing activities increased \$394.9 million from 1994 to 1995 primarily due to the sale of the Marshalls division.

Net cash used in financing activities decreased \$15.5 million to \$341.2 million in 1996 primarily due to (i) the Revised Dividend, (ii) a reduction of the amount of cash used to reduce notes payable and (iii) the proceeds received from the exercise of stock options. The favorable impact of these changes was offset partially by a decrease in book overdrafts. Net cash used in financing activities increased \$265.4 million to \$356.7 million from 1994 to 1995 primarily due to a \$148 million reduction in notes payable and the repurchase of approximately \$26.3 million of the Company's common stock in connection with managing the Company's stock incentive plans.

During 1997, the Company intends to sell the note receivable that was received as a portion of the proceeds from the sale of the Kay-Bee Toys division. In addition, the Company intends to sell, subject to market conditions, its remaining 32.5% ownership interest in Linens 'n Things, Inc. See Note 5 to the consolidated financial statements for further information about these investments.

Management believes that the Company's cash on hand and cash provided by operations, together with its ability to secure short-term financing through commercial paper and bank loan participation notes, will be sufficient to cover the combined working capital, capital expenditure and debt service requirements of CVS and Revco in the event the contemplated merger is completed.

Capital Expenditures

Capital expenditures were \$224.4 million, \$395.0 million and \$421.4 million in 1996, 1995 and 1994, respectively. These expenditures were primarily for (i) new stores, (ii) improvements to existing stores, (iii) store equipment, (iv) information systems and (v) distribution and office facilities. The lower capital expenditure level in 1996 was primarily due to the Dispositions.

Accounting Changes

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." While SFAS No. 123 established financial accounting and reporting standards for stock-based employee compensation plans using a fair value method of accounting, it allows companies to continue to measure compensation using the intrinsic value method of accounting prescribed in APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Company will continue to use its present APB No. 25 accounting treatment for stock-based compensation. See Note 14 to the consolidated financial statements for further information about SFAS No. 123.

Effective October 1, 1995, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and recorded a pre-tax asset impairment charge of \$110.4 million (\$5.0 million of which pertained to continuing operations) in connection with the write-down of certain fixed and intangible assets. See Note 1 to the consolidated financial statements for further information.

During the fourth quarter of 1995, the Company changed its policy from capitalizing internally developed software costs to expensing the costs as incurred and recorded a charge of \$74.5 million (\$37.8 million of which pertained to continuing operations). The effect of the change in accounting principle has been treated as a change in accounting principle that is inseparable from the effect of the change in accounting estimate. As a result, the entire amount has been treated as a change in accounting estimate. The effect of this charge was to reduce net earnings by \$45.8 million, or \$4.4 per common share in 1995.

Cautionary Statement Concerning Forward-Looking Statements

We have made forward-looking statements in this Annual Report that are subject to risks and uncertainties. Forward-looking statements include the information concerning future results of operations of CVS after completion of the merger with Revco; the information concerning CVS' ability to continue to achieve significant sales growth; the information concerning CVS' ability to continue to reduce selling, general and administrative expenses as a percentage of net sales; the information concerning CVS' intention to sell a certain note receivable in 1997; and the information concerning CVS' intention to sell its remaining 32.5% ownership interest in Linens 'n Things, Inc. in 1997; as well as those preceded by, followed by or that otherwise include the words: "believes," "expects," "anticipates," "intends," "estimates" or other similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should understand that the following important factors, in addition to those discussed elsewhere in this Annual Report (including in the notes to the consolidated financial statements included herein) and in our Annual Report on Form 10-K for the year ended December 31, 1996, could affect the future results of CVS and could cause those results to differ materially from those expressed in our forward-looking statements: materially adverse changes in economic conditions generally or in the markets served by CVS; material changes in inflation; a significant delay in the expected closing of the merger with Revco; future regulatory actions affecting the chain-drug industry; competition from other drugstore chains, from alternative distribution channels such as supermarkets, mass merchants, membership clubs, other retailers and mail order companies; and from third party plans; and the continued efforts of health maintenance organizations, managed care organizations, patient benefit management companies and other third party payors to reduce prescription drug costs. The forward-looking statements referred to above are also subject to uncertainties and assumptions relating to the operations and results of operations of CVS, including: risks relating to CVS' ability to combine the businesses of CVS and Revco and the challenges inherent in diverting CVS' management focus and resources from other strategic opportunities and from operational matters for an extended period of time during the integration process; CVS' ability to continue to secure suitable new store locations on favorable lease terms, CVS' ability to continue to purchase inventory on favorable terms; and CVS' ability to attract, hire and retain suitable pharmacists and management personnel.

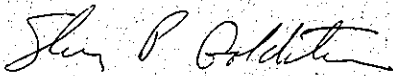
Management's Responsibility for Financial Reporting

The integrity and objectivity of the financial statements and related financial information in this report are the responsibility of the management of the Company. The financial statements have been prepared in conformity with generally accepted accounting principles and include, when necessary, the best estimates and judgments of management.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded, transactions are executed in accordance with management's authorization, and the accounting records provide a reliable basis for the preparation of the financial statements. The system of internal accounting controls is continually reviewed by management and improved and modified as necessary in response to changing business conditions and recommendations of the Company's internal auditors and independent auditors.

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets periodically with management, internal auditors and the independent auditors to review matters relating to the Company's financial reporting, the adequacy of internal accounting controls and the scope and results of audit work. The internal auditors and independent auditors have free access to the Audit Committee.

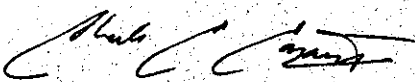
KPMG Peat Marwick LLP, certified public accountants, are engaged to audit the consolidated financial statements of the Company. Their Independent Auditors' Report, which is based on an audit made in accordance with generally accepted auditing standards, expresses an opinion as to the fair presentation of these financial statements.



Stanley P. Goldstein
Chairman of the Board and Chief Executive Officer



Thomas M. Ryan
Vice Chairman and Chief Operating Officer



Charles C. Conaway
Executive Vice President and Chief Financial Officer

February 6, 1997

Independent Auditors' Report

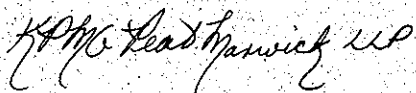
To the Board of Directors and Shareholders of CVS Corporation:

We have audited the accompanying consolidated balance sheets of CVS Corporation as of December 31, 1996 and 1995 and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects the financial position of CVS Corporation at December 31, 1996 and 1995 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1996 in conformity with generally accepted accounting principles.

As discussed in notes to consolidated financial statements, the Company has adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" effective October 1, 1995.



KPMG Peat Marwick LLP
Providence, Rhode Island

February 6, 1997

Consolidated Statements of Operations

CVS Corporation

In millions, except per share amounts	Years Ended December 31,		
	1996	1995	1994
Net sales	\$5,528.1	\$4,865.0	\$4,330.1
Cost of goods sold, buying and warehousing costs	3,978.1	3,506.4	3,088.2
Gross margin	1,550.0	1,358.6	1,241.9
Selling, general and administrative expenses	1,174.1	1,113.3	994.4
Depreciation and amortization	76.3	71.1	63.7
Restructuring and asset impairment charges	—	165.6	—
Total operating expenses	1,250.4	1,350.0	1,058.1
Operating profit	299.6	8.6	183.8
Gain on sale of securities	121.4	—	—
Dividend income	5.6	—	—
Interest expense, net	(23.2)	(53.5)	(30.8)
Other income (expense), net	103.8	(53.5)	(30.8)
Earnings (loss) from continuing operations before income taxes	403.4	(44.9)	153.0
Income tax (provision) benefit	(163.8)	18.4	(62.7)
Earnings (loss) from continuing operations	239.6	(26.5)	90.3
Discontinued operations:			
(Loss) earnings from operations, net of income tax benefit (provision) of \$31.0, \$171.4 and \$(156.0) in 1996, 1995 and 1994, respectively and minority interest of \$51.9 in 1994	(54.8)	(607.4)	217.2
Estimated loss on disposal, net of income tax benefit of \$56.2 and \$9.9 and minority interest of \$22.2 and \$38.4 in 1996 and 1995, respectively	(109.4)	(23.2)	—
(Loss) earnings from discontinued operations	(164.2)	(630.6)	217.2
Net earnings (loss)	\$ 75.4	\$ (657.1)	\$ 307.5
Preferred dividends, net	(14.5)	(17.0)	(17.0)
Net earnings (loss) available to common shareholders	\$ 60.9	\$ (674.1)	\$ 290.5
Per common share:			
Earnings (loss) from continuing operations	\$ 2.12	\$ (.41)	\$.70
(Loss) earnings from discontinued operations	(1.55)	(6.00)	2.05
Net earnings (loss)	\$.57	\$ (6.41)	\$ 2.75
Weighted average common shares outstanding	105.7	105.1	105.5
Dividends per common share	\$.44	\$ 1.52	\$ 1.52

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

CVS Corporation

<i>In millions</i>	<i>December 31,</i>	
	1996	1995
Assets:		
Cash and cash equivalents	\$ 423.9	\$ 129.6
Investments	179.4	175.0
Accounts receivable, net	160.8	296.4
Inventories	1,031.4	1,673.0
Prepaid expenses	177.2	286.0
Total current assets	1,972.7	2,560.0
Property and equipment, net	606.5	1,114.4
Deferred charges and other assets	131.9	91.6
Goodwill, net	120.7	195.6
Total assets	\$2,831.8	\$3,961.6
Liabilities:		
Accounts payable	\$ 507.7	\$ 690.7
Accrued expenses	639.9	1,039.8
Notes payable	—	52.0
Federal income taxes	16.1	—
Other current liabilities	18.2	15.2
Total current liabilities	1,181.9	1,797.7
Long-term debt	303.7	327.7
Deferred income taxes	20.6	9.1
Other long-term liabilities	80.5	184.2
Minority interest in subsidiaries	—	93.8
Redeemable preferred stock	—	1.3
Shareholders' equity:		
Preference stock	298.6	334.9
Common stock	1.1	111.7
Treasury stock	(273.2)	(304.6)
Guaranteed ESOP obligation	(292.1)	(309.7)
Capital surplus	199.1	54.9
Retained earnings	1,314.0	1,660.4
Other	(2.4)	.2
Total shareholders' equity	1,245.1	1,547.8
Total liabilities and shareholders' equity	\$2,831.8	\$3,961.6

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

CVS Corporation

In millions	Years Ended December 31,					
	Shares			Dollars		
	1996	1995	1994	1996	1995	1994
Preference stock:						
Beginning of year	6.3	6.4	6.5	\$ 334.9	\$ 340.9	\$ 347.3
Conversion to common stock	(.7)	(.1)	(.1)	(36.3)	(6.0)	(6.4)
End of year	5.6	6.3	6.4	298.6	334.9	340.9
Common stock:						
Beginning of year	111.6	111.4	111.2	111.7	111.5	111.3
Stock options exercised and awards under stock plans	.8	.2	.2	.8	.2	.2
Effect of change in par value	—	—	—	(111.4)	—	—
End of year	112.4	111.6	111.4	1.1	111.7	111.5
Treasury stock:						
Beginning of year	(6.5)	(5.8)	(5.9)	(304.6)	(283.8)	(289.7)
Repurchase of common stock	—	(.8)	—	—	(26.3)	—
Conversion of preference stock	.7	.1	.1	31.7	5.5	5.9
Other	—	—	—	(.3)	—	—
End of year	(5.8)	(6.5)	(5.8)	(273.2)	(304.6)	(283.8)
Guaranteed ESOP obligation:						
Beginning of year				(309.7)	(328.1)	(328.6)
Reduction of guaranteed ESOP obligation				17.6	18.4	.5
End of year				(292.1)	(309.7)	(328.1)
Capital surplus:						
Beginning of year				54.9	48.1	42.1
Conversion of preference stock				4.6	.5	.5
Stock options exercised and awards under stock plans				27.4	6.3	5.5
Issuance of additional shares due to Footstar Distribution				.8	—	—
Effect of change in par value				111.4	—	—
End of year				199.1	54.9	48.1
Retained earnings:						
Beginning of year				1,660.4	2,494.4	2,364.3
Net earnings (loss)				75.4	(657.1)	307.5
Dividends:						
Preference stock, net				(14.4)	(16.9)	(16.9)
Redeemable preferred stock				(.1)	(.1)	(.1)
Common stock				(46.5)	(159.9)	(160.4)
Footstar Distribution				(360.8)	—	—
End of year				1,314.0	1,660.4	2,494.4
Other:						
Beginning of year				.2	(1.4)	—
Cumulative translation adjustment				(.2)	1.6	(1.4)
Unrealized loss on investments, net				(2.4)	—	—
End of year				(2.4)	.2	(1.4)
Total shareholders' equity				\$1,245.1	\$1,547.8	\$2,381.6

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

CVS Corporation

<i>In millions</i>	<i>Years Ended December 31,</i>		
	1996	1995	1994
Cash flows from operating activities:			
Net earnings (loss)	\$ 75.4	\$(657.1)	\$ 307.5
Adjustments required to reconcile net earnings (loss) to net cash provided by operating activities:			
Restructuring and asset impairment charges	235.0	982.4	—
Depreciation and amortization	133.7	228.3	206.3
Gain on sale of securities	(121.4)	—	—
Minority interest in net earnings	22.2	38.4	51.9
Income from unconsolidated subsidiary	(4.5)	—	—
Deferred income taxes and other non-cash items	84.1	(130.3)	2.0
Change in assets and liabilities, excluding acquisitions and dispositions:			
Decrease (increase) in accounts receivable, net	37.0	(30.0)	(15.0)
(Increase) in inventories	(247.6)	(214.3)	(266.1)
(Increase) in prepaid expenses, deferred charges and other assets	(98.9)	(21.5)	(14.1)
Increase in accounts payable	293.0	179.1	74.0
(Decrease) increase in accrued expenses	(257.4)	46.4	51.8
(Decrease) increase in Federal income taxes payable and other liabilities	(16.9)	(75.9)	100.1
Net cash provided by operating activities	133.7	345.5	498.4
Cash flows from investing activities:			
Additions to property and equipment	(224.4)	(395.0)	(421.4)
Proceeds from sale of divisions and other property and equipment	240.4	423.6	86.9
Proceeds from initial public offering of Linens 'n Things, Inc.	189.4	—	—
Proceeds from sale of securities	296.4	—	—
Acquisitions, net of cash	—	(4.8)	(36.6)
Net cash provided by (used in) investing activities	501.8	23.8	(371.1)
Cash flows from financing activities:			
Dividends paid or payable	(132.2)	(240.0)	(225.5)
(Reductions in) additions to notes payable	(52.0)	(148.0)	110.0
(Decrease) increase in book overdrafts	(170.3)	65.8	26.9
Repurchase of common stock	—	(26.3)	—
Reductions of long-term debt and obligations under capital leases	(13.3)	(10.5)	(4.4)
Proceeds from exercise of stock options and other issuances of stock	27.9	7	—
Other	(1.3)	1.6	1.7
Net cash used in financing activities	(341.2)	(356.7)	(91.3)
Net increase in cash and cash equivalents	294.3	12.6	36.0
Cash and cash equivalents at beginning of year	129.6	117.0	81.0
Cash and cash equivalents at end of year	\$ 423.9	\$ 129.6	\$ 117.0

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

CVS Corporation

1 Significant Accounting Policies

Business—CVS Corporation (“CVS” or the “Company”), formerly known as Melville Corporation (“Melville”), primarily operates as a single business segment, 1,408 retail drugstores in 13 Northeast and Middle Atlantic states, Georgia and the District of Columbia. CVS offers customers convenience, selection, and superior customer service as well as comprehensive prescription and pharmacy services.

Basis of presentation—The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated.

As a result of the Company's strategic restructuring plan, the results of operations of the former (i) footwear segment (which includes the Meldisco, Footaction and Thom McAn divisions), (ii) apparel segment (which includes the Marshalls, Wilsons, and Bob's divisions) and (iii) toys and home furnishings segment (which includes the Kay-Bee Toys, This End Up and Linens 'n Things divisions) have been classified as discontinued operations in the accompanying consolidated statements of operations for all periods presented.

At December 31, 1996, the Company continues to own 32.5% of its former wholly-owned subsidiary Linens 'n Things, Inc. This investment is being accounted for using the equity method. The Company has announced its intention to dispose of, subject to market conditions, its remaining ownership interest in Linens 'n Things, Inc. during 1997. As a result, this investment has been classified as a current asset in the accompanying December 31, 1996 consolidated balance sheet.

See Note 2 for further information about the Company's strategic restructuring program.

Use of estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and cash equivalents—Cash and cash equivalents, which consist of cash and temporary investments with maturities of three months or less when purchased, are stated at cost which approximates market.

Inventories—Inventories are stated at the lower of cost or market using the first-in, first-out (“FIFO”) method. At December 31, 1995, certain inventories at the Kay-Bee Toys, Thom McAn and This End Up divisions were accounted for using the last-in, first out (LIFO) method. As discussed in Note 2, these divisions were disposed of during 1996.

Property and equipment—Depreciation of property and equipment is computed on a straight line basis, generally over the estimated useful lives of the assets or, when applicable, the life of the lease, whichever is shorter. Estimated useful lives generally range from 10 to 40 years for buildings and improvements, 5 to 10 years for fixtures and equipment, and 5 to 10 years for leasehold improvements.

Impairment of long-lived assets—An impairment loss is recognized whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company primarily groups and evaluates assets at an individual store level, which is the lowest level at which independent cash flows can be identified. When evaluating assets for potential impairment, the Company considers historical performance and, in addition, estimates future results. If the carrying amount of the related assets exceed the expected future cash flows, the Company considers the assets to be impaired and records an impairment loss.

Deferred charges and other assets—Deferred charges, consisting primarily of beneficial leasehold costs, are amortized on a straight-line basis, over the remaining life of the leasehold acquired. Other assets primarily include notes receivable that were received as a portion of the proceeds from the sale of certain former divisions. The Company intends to hold these notes until maturity.

Goodwill—Goodwill is the excess of the cost of net assets acquired in business combinations over their fair value. It is amortized on a straight-line basis generally over periods of forty years. Accumulated amortization was \$22.3 million at December 31, 1996 and \$28.2 million at December 31, 1995. The Company evaluates goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In completing its evaluation, the Company compares estimated future cash flows to the carrying amount of goodwill. If the carrying amount of goodwill exceeds the expected future cash flows, the Company considers the goodwill to be impaired and records an impairment loss.

Financial instruments—The Company's financial instruments primarily include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. Due to the short-term nature of these financial instruments, the Company's carrying value approximates fair value.

Maintenance and repairs—Maintenance and repair costs are charged directly to expense as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated.

Store opening and closing costs—New store opening costs are charged directly to expense as incurred. In the event a store closes before its lease expires, the remaining lease obligation, less anticipated sublease rental income, is provided for in the year of closing.

Advertising costs—External costs incurred to produce media advertising are charged to expense when the advertising takes place.

Federal income taxes—The Company and its wholly-owned subsidiaries file a consolidated Federal income tax return. The tax benefit for dividends on unallocated shares of Series One ESOP Convertible Preference Stock is recorded as a credit to retained earnings.

Postretirement Benefits—The annual cost of postretirement benefits is funded in the period incurred and the cost is recognized over an employee's term of service with the Company.

Earnings per common share—Primary earnings per share is computed by dividing (i) net earnings, after deducting net dividends on redeemable preferred stock and ESOP preference stock ("Primary Earnings") by (ii) the weighted average number of common shares outstanding during the year assuming the exercise of stock options ("Primary Shares").

Fully diluted earnings per share assumes that the ESOP preference stock is converted into common stock. Fully diluted earnings per share is computed by dividing (i) Primary Earnings, after accounting for the difference between the current dividends on the ESOP preference stock and the common stock and after making adjustments for certain non-discretionary expenses that are based on net earnings such as incentive bonuses and profit sharing by (ii) Primary Shares plus the number of additional common shares that would be issued upon the conversion of the ESOP preference stock. Fully diluted earnings per share presentation is not required on the face of the consolidated statements

of operations due to the results of the materiality tests mandated by Accounting Principles Board ("APB") Opinion No. 15, "Earnings Per Share."

Accounting changes—Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." While SFAS No. 123 established financial accounting and reporting standards for stock-based employee compensation plans using a fair value method of accounting, it allows companies to continue to measure compensation using the intrinsic value method of accounting as prescribed in APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Company will continue to use its present APB No. 25 accounting treatment for stock-based compensation. See Note 14 for further information about SFAS No. 123.

Effective October 1, 1995, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and recorded a pre-tax asset impairment charge of \$1104 million (\$5.0 million of which pertained to continuing operations) in connection with the write-down of certain fixed and intangible assets. The above charge resulted when the Company began identifying and measuring impairment at a lower level under SFAS No. 121 than under its previous accounting policy. Under the Company's previous policy, each of the Company's operating divisions' long-lived assets were evaluated as a group for impairment at the division level if the division was either incurring operating losses or was expecting to incur operating losses in the future. Since the expected future cash flows measured at the division level were in excess of the carrying value of the related divisional assets, no previous impairment losses were recorded.

During the fourth quarter of 1995, the Company changed its policy from capitalizing internally developed software costs to expensing the costs as incurred and recorded a charge of \$74.5 million (\$37.8 million of which pertained to continuing operations). The effect of the change in accounting principle has been treated as a change in accounting principle that is inseparable from the effect of the change in accounting estimate. As a result, the entire amount has been treated as a change in accounting estimate. The effect of this charge was to reduce net earnings by \$45.8 million, or \$44 per common share in 1995.

Reclassifications—Certain reclassifications have been made to the consolidated financial statements of prior years to conform to the 1996 presentation.

② Strategic Restructuring Program

The 1995 Plan

On October 24, 1995 (the "1995 Measurement Date"), the Board of Directors approved a comprehensive restructuring plan that was the product of a strategic review initiated in 1994. The restructuring plan included, among other things, (i) the continued operation of CVS (which includes CVS, and initially the Linens 'n Things and Bob's divisions), (ii) the disposal of the Marshalls, Kay-Bee Toys, Wilsons and This End Up divisions, (iii) the spin-off of Footstar, Inc. ("Footstar"), which includes the Meldisco, Footaction and Thom McAn divisions, and (iv) the elimination of certain corporate overhead costs.

In connection with the approval of the 1995 Plan, the Company recorded a pre-tax charge of \$872.0 million in the fourth quarter of 1995 (the "1995 Charge") and discontinued the footwear segment in accordance with APB Opinion No. 30, "Reporting the Results of Operations—Reporting the effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." As a result of the 1996 Plan discussed below, the apparel segment and toys and home furnishings segment were also discontinued. Accordingly, the portion of the 1995 Charge that pertains to these segments, \$711.4 million, is reflected as a component of discontinued operations, and the remainder, \$160.6 million, is included in continuing operations. The amount recorded in continuing operations primarily includes costs associated with (i) exiting certain geographic markets, (ii) closing duplicate warehouse facilities and (iii) closing Melville's Corporate Headquarters. These costs primarily include asset write-offs, closed store and warehouse lease liabilities and employee severance. Management determined the amount of (i) asset write-offs by comparing the carrying value of the assets to be disposed of to the anticipated proceeds, (ii) closed store and warehouse lease liabilities by calculating the present value of the future minimum lease payments and (iii) employee severance based on an employee's compensation and years of service with the Company. The Company applied the provisions of EITF 94-3 to determine the appropriate accounting treatment for these charges.

Asset write-offs included in the 1995 Charge totaled \$659.7 million. The balance of the charge, \$212.3 million, will require cash outlays of which \$85.7 million had been incurred as of December 31, 1996. The remaining cash outlays are expected to be incurred primarily in 1997.

In connection with various components of the 1995 Plan, positions for approximately 1,200 store employees and 400 administrative employees have been eliminated.

At December 31, 1996, the 1995 Plan had been completed without significant changes to the Board approved plan. As a result, the Company expects that earnings from continuing operations before income taxes will improve by approximately \$38 million on an annual basis (projected 1997 versus 1995) primarily due to the elimination of certain corporate overhead costs.

The 1996 Plan

On May 29, 1996 (the "1996 Measurement Date"), the Board of Directors approved further refinements to the restructuring plan. The refinements included (i) a formal plan to separate the Linens 'n Things and Bob's divisions from CVS and (ii) a formal plan to convert 80 to 100 of Thom McAn's stores to the Footaction store format and to exit the Thom McAn business by mid-1997.

In connection with the approval of the 1996 Plan, the Company recorded, as a component of discontinued operations, a pre-tax charge of \$235.0 million during the second quarter of 1996 (the "1996 Charge"), substantially all of which related to asset write-offs that will not require net cash outlays. As a result of adopting the plan to separate the Linens 'n Things and Bob's divisions from CVS, the apparel and toys and home furnishings segments were discontinued in accordance with APB Opinion No. 30.

The Company expects that the 1996 Plan will be completed during 1997 without significant changes to the Board approved plan.

The asset write-offs of \$659.7 million and \$235.0 million included in the 1995 Charge and 1996 Charge, respectively, primarily relate to the write-down of the operating divisions to be disposed of to estimated fair value. The significant judgment included in the above write-offs relates to the estimation of fair value for each division. These estimates were prepared by independent third parties.

The Disposals

On November 17, 1995, the Company completed the sale of the Marshalls division to The TJX Companies, Inc. for total proceeds of approximately \$600 million.

On May 4, 1996, the Company completed the sale of the Kay-Bee Toys division to Consolidated Stores Corporation for total proceeds of approximately \$285.7 million.

On May 25, 1996, the Company completed the sale of the Wilsons division to an investor group led by Wilsons' management for total proceeds of approximately \$69.7 million.

On May 31, 1996, the Company completed the sale of the This End Up division to an investor group for approximately \$18.2 million.

On October 12, 1996, the Company completed the spin-off of Footstar by distributing 100% of the shares of Footstar common stock held by CVS to its shareholders of record as of the close of business on October 2, 1996 (the "Footstar Distribution"). See Note 20 for further information about the Footstar Distribution.

On December 2, 1996, the Company completed the initial public offering of 67.5% of Linens 'n Things, Inc. (the "Linens IPO") for net proceeds of approximately \$1894 million.

The gain and losses that resulted from the above disposals are reflected in the "Discontinued Operations" section of the

Consolidated Statements of Operations. The 1996 Charge includes approximately \$47 million related to finalizing certain disposals accrued for in the 1995 Charge. The Company has no continuing involvement with the divested operations.

Other Events

On October 16, 1996, the Company's trading symbol on the New York Stock Exchange was changed to "CVS" from "MES."

On November 20, 1996, the Company officially changed its name to CVS Corporation from Melville Corporation.

Following is a summary of the significant components of the 1995 Charge and the 1996 Charge:

In millions	1995 Charge	Utilized in 1995 ⁽¹⁾	Reserve Balance at 12/31/95 ⁽⁴⁾	1996 Charge	Utilized in 1996 ⁽¹⁾⁽²⁾⁽³⁾	Reserve Balance at 12/31/96 ⁽⁴⁾⁽⁵⁾
Loss on sale of divisions	\$587.1	\$382.2	\$204.9	\$134.7	\$177.1	\$162.5
Lease obligations and asset write-offs relating to store, office and warehouse closings	146.7	66.4	80.3	5.7	30.5	55.5
Contract termination costs and asset write-offs relating to outsourcing certain technology functions	64.3	40.3	24.0	—	19.2	4.8
Severance and employee benefits	48.0	.2	47.8	10.6	23.3	35.1
Costs relating to the consolidation of the footwear divisions and exit from Thom McAn	20.0	.4	19.6	84.0	103.6	—
Other	5.9	5.9	—	—	—	—
	\$872.0	\$495.4	\$376.6	\$235.0	\$353.7	\$257.9

⁽¹⁾ \$6.1 million and \$79.6 million of the amounts utilized in 1995 and 1996, respectively, required cash outlays.

⁽²⁾ \$80.0 million of the amount utilized in 1996 represents reserve balances that were retained by Footstar.

⁽³⁾ \$2.4 million of the amount utilized in 1996 represents reserve balances that were retained by Linen 'n Things, Inc.

⁽⁴⁾ \$36.8 million and \$12.0 million of the balance at December 31, 1995 and 1996, respectively, is included in balance sheet classifications other than accrued expenses.

⁽⁵⁾ The Company believes that the reserve balance at December 31, 1996 is adequate to cover the remaining costs associated with the strategic restructuring program.

3 Discontinued Operations

Following is a summary of discontinued operations by reporting segment for the years ended December 31:

In millions	1996	1995	1994
Net sales:			
Footwear	\$1,391.1	\$1,827.3	\$1,839.9
Apparel	526.4	3,055.7	3,538.9
Toys and Home Furnishings	900.3	1,768.4	1,576.7
	\$2,817.8	\$6,651.4	\$6,955.5
Operating (loss) profit: ⁽¹⁾			
Footwear	\$ (12.4)	\$ 47.5	\$ 160.5
Apparel	(171.3)	(704.0)	161.1
Toys and Home Furnishings	(49.7)	(115.9)	99.4
	\$ (233.4)	\$ (772.4)	\$ 421.0

⁽¹⁾ Includes the effect of the 1995 Charge and the 1996 Charge.

Following is a summary of the assets and liabilities of discontinued operations by reporting segment as of December 31:

In millions	1996	1995
Assets:		
Footwear	\$ —	\$ 650.5
Apparel	141.0	313.9
Toys and Home Furnishings	—	811.3
	\$141.0	\$1,775.7
Liabilities:		
Footwear	\$ —	\$ 347.6
Apparel	61.0	125.5
Toys and Home Furnishings	—	356.8
	\$ 61.0	\$ 829.9

④ Accounts Receivable

Accounts receivable consisted of the following at December 31:

<i>In millions</i>	1996	1995
Trade	\$145.1	\$159.5
Federal income taxes	—	22.4
Other	25.8	147.9
	170.9	329.8
Less allowance for doubtful accounts	(10.1)	(33.4)
	\$160.8	\$296.4

⑤ Investments

Investments consisted of the following at December 31:

<i>In millions</i>	1996	1995
Note receivable	\$100.0	\$ —
Investment in Linens 'n Things, Inc.	83.2	—
TJX preferred stock	—	175.0
	183.2	175.0
Unrealized loss on note receivable	(3.8)	—
	\$179.4	\$175.0

The note receivable, which matures on May 4, 2000, was received as a portion of the proceeds from the sale of the Kay-Bee Toys division. The Company intends to sell this note to a third party in 1997. At December 31, 1996, the fair market value of this investment was approximately \$96.2 million, which represents the present value of the expected future cash flows discounted at an interest rate that the Company considers to be appropriate for a loan that would currently be offered to a company with comparable credit risk.

As discussed in Notes 1 and 2, the Company continues to own 32.5% of Linens 'n Things, Inc. At December 31, 1996, the fair market value of this investment was approximately \$123 million based on quoted market prices.

During 1996, the Company completed the sale of the TJX preferred stock for total proceeds of approximately \$296.4 million. The sale of these securities resulted in a gain of \$121.4 million.

Except for the investment in Linens 'n Things, Inc., the above assets are classified as available-for-sale securities and are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of shareholders' equity until realized.

⑥ Inventories

Inventories consisted of the following at December 31:

<i>In millions</i>	1996	1995
Finished goods	\$1,031.4	\$1,661.7
Work-in-process	—	.8
Raw materials and supplies	—	10.5
	\$1,031.4	\$1,673.0

⑦ Prepaid Expenses

Prepaid expenses consisted of the following at December 31:

<i>In millions</i>	1996	1995
Deferred income taxes	\$154.8	\$228.1
Other	22.4	57.9
	\$177.2	\$286.0

8 Property and Equipment

Property and equipment consisted of the following at December 31:

In millions	1996	1995
Land	\$ 55.6	\$ 56.7
Buildings and improvements	160.9	244.3
Fixtures and equipment	461.4	910.1
Leasehold improvements	237.1	483.3
Capital leases	3.3	13.5
	918.3	1,707.9
Accumulated depreciation and amortization	(311.8)	(593.5)
	\$606.5	\$1,114.4

9 Accrued Expenses

Accrued expenses consisted of the following at December 31:

In millions	1996	1995
Restructuring reserves	\$245.9	\$ 339.8
Taxes other than Federal income taxes	58.9	121.0
Salaries and wages	49.7	70.7
Rent	40.8	78.0
Other	244.6	430.3
	\$639.9	\$1,039.8

10 Short-Term Borrowing Arrangements

Following is a summary of short-term borrowings outstanding at December 31:

In millions	1996	1995
Commercial paper	\$ —	\$ 52.0
Weighted average interest rate	—	5.9%
Lines of credit available	\$320.0	\$1,148.0
Letters of credit outstanding	\$ 11.9	\$ 331.4

The Company primarily uses commercial paper to finance its seasonal inventory requirements and capital expenditures. The Company's commercial paper program is supported by a \$320 million, five-year unsecured revolving credit facility. The Company can also obtain short-term financing through the issuance of bank loan participation notes.

There were no short-term borrowings outstanding at December 31, 1996. The Company is not obligated under any formal or informal compensating balance agreements.

11 Long-Term Debt

Long-term debt consisted of the following at December 31:

In millions	1996	1995
Guaranteed ESOP note, 8.52%, payable in various installments through 2008 ⁽¹⁾	\$309.4	\$323.0
Other notes and mortgages payable	12.2	19.0
	321.6	342.0
Less current installments	(17.9)	(14.3)
	\$303.7	\$327.7

⁽¹⁾ See Note 18 for further information about the Company's ESOP Plan.

At December 31, 1996, the aggregate long-term debt maturing during each of the next five years was as follows: \$17.9 million in 1997, \$21.5 million in 1998, \$13.8 million in 1999, \$16.5 million in 2000 and \$20.8 million in 2001.

Following is a summary of net interest expense for the years ended December 31:

In millions	1996	1995	1994
Interest expense ⁽¹⁾	\$30.7	\$53.9	\$31.8
Less interest income and capitalized interest	(7.5)	(.4)	(1.0)
Net interest expense	\$23.2	\$53.5	\$30.8

⁽¹⁾ In accordance with the provisions of Statement of Position 76-3, "Accounting Practices for Certain Employee Stock Ownership Plans" and allowable under the transition provisions of Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans," interest expense excludes interest related to the guaranteed ESOP note, but includes interest recognized in connection with the Company's contribution to the ESOP Plan.

12 Leases

The Company and its subsidiaries lease retail stores, warehouse facilities and office facilities over periods generally ranging from 5 to 20 years and generally has options to renew such terms over periods ranging from 5 to 15 years.

Following is a summary of the future minimum lease payments under capital leases, rental payments required under operating leases, and future minimum sublease rentals, excluding lease obligations for closed stores, at December 31, 1996:

In millions	Capital Leases	Operating Leases
1997	\$.6	\$ 190.3
1998	.6	183.4
1999	.6	171.2
2000	.4	161.8
2001	.4	148.4
Thereafter	1.6	908.3
	\$4.2	\$1,763.4
Less amount representing interest	(2.1)	
Present value of minimum lease payments	\$2.1	
Total future minimum sublease rentals	\$ —	\$ 30.8

Following is a summary of net rental expense for operating leases relating to continuing operations for the years ended December 31:

In millions	1996	1995	1994
Minimum rentals	\$176.0	\$170.7	\$154.1
Contingent rentals based on sales	30.2	25.2	21.9
	206.2	195.9	176.0
Less sublease rentals	(10.1)	(7.7)	(7.7)
	\$196.1	\$188.2	\$168.3

13 Contingencies

In connection with certain dispositions completed between 1991 and 1996, the Company continues to guarantee lease obligations for approximately 2,600 former stores. The Company is indemnified for these obligations by the respective purchasers. Assuming that each respective purchaser became insolvent, an event which the Company believes to be highly unlikely, management estimates that it could settle these obligations for

approximately \$1.3 billion at December 31, 1996. In the opinion of management, the ultimate disposition of these guarantees will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

The Company is also a defendant in various lawsuits arising in the ordinary course of business. In the opinion of management and the Company's outside counsel, the ultimate disposition of these lawsuits, exclusive of potential insurance recoveries, will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows.

14 Stock Incentive Plans

As discussed in Note 1, the Company applies APB Opinion No. 25 and related interpretations to account for its stock incentive plans. Pro forma disclosures as if the Company adopted the cost recognition requirements of SFAS No. 123 are presented below.

The Company's 1990 Omnibus Stock Incentive Plan (the "Omnibus Plan"), as amended, provides for the granting of up to 9,238,942 shares of common stock to key employees in the form of options, restricted stock and other stock-based awards. In 1996, the maximum number of shares available for grant was adjusted for the effect of the Footstar Distribution. The Omnibus Plan replaced the Company's 1973 and 1987 Stock Option Plans and the 1980 Restricted Stock Plan (collectively, the "Previous Employee Plans").

Stock options granted under the Omnibus Plan are awarded at fair market value on the date of the grant. The right to exercise these options generally commences between one and three years from the date of the grant and expires ten years after the date of the grant, provided that the option holder continues to be employed by the Company.

The 1996 Directors Stock Plan (the "1996 Directors Plan"), provides for the granting of up to 173,230 shares of common stock to the Company's non-employee directors (the "Eligible Directors"). In 1996, the maximum number of shares available for grant was adjusted for the effect of the Footstar Distribution. Eligible Directors (i) are entitled to receive an annual grant of

347 shares of common stock, (ii) are paid one-half of their annual retainer fee in shares of common stock and (iii) may elect to receive common stock as compensation for certain other services rendered. In addition, Eligible Directors may elect to defer compensation payable in common stock until their service as a director concludes. In this case, Eligible Directors are entitled to receive dividend equivalent credits on their deferred shares. The 1996 Directors Plan replaced the Company's 1989 Directors Stock Option Plan (the "Previous Directors Plan").

In connection with the termination of certain retirement benefits, the 1996 Directors Plan provided each Eligible Director the option to receive the actuarial present value of these benefits in the form of a common stock grant in lieu of receiving the previously accrued benefit in pension payments upon retirement. All Eligible Directors elected to receive the common stock grant and to defer the grant until their service as a director concludes. The impact of this grant was not material to the Company's results of operations.

Following is a summary of the activity in the Omnibus Plan, the 1996 Directors Plan, the Previous Employee Plans and the Previous Directors Plan:

	1996		1995		1994	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	7,616,005	\$35.27	4,143,867	\$38.08	4,008,084	\$38.12
Granted	1,108,673	33.45	3,519,719	31.89	232,128	32.35
Exercised	(910,640)	30.78	(20,095)	27.16	(88,261)	24.57
Canceled	(2,210,456)	37.58	(27,486)	32.37	(8,084)	38.97
Outstanding at end of year	5,603,582	\$34.73	7,616,005	\$35.27	4,143,867	\$38.08
Options exercisable at year-end	3,403,940		4,108,217		3,925,594	

Following is a summary of fixed stock options outstanding at December 31, 1996:

Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Years of Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$23.14 to 35.72	4,128,253	7.59	\$32.53	1,928,611	\$32.11
36.85 to 39.72	786,632	5.76	39.14	786,632	39.14
40.05 to 47.41	688,697	4.71	42.85	688,697	42.85
\$23.14 to 47.41	5,603,582	6.98	\$34.73	3,403,940	\$35.91

The number of shares and the weighted-average exercise prices included in the above tables have been restated to reflect the effect of the Footstar Distribution.

At December 31, 1996, approximately 1.6 million of the 5.6 million stock options outstanding were held by employees of divisions sold or to be sold, or by employees terminated under the Company's strategic restructuring program. These individuals may exercise their options for a 90 day period following termination.

The Omnibus Plan also permits the granting of performance share awards, representing rights to receive common stock grants based upon certain performance criteria over a three-year performance period, and performance based restricted share awards, representing rights to receive common stock grants based upon certain performance criteria over a one-year performance period. Compensation expense related to grants under these provisions is based on the current market price of the Company's common stock and the extent to which the performance criteria is being met.

Following is a summary of performance shares and performance based restricted shares for the years ended December 31:

<i>Dollars in millions</i>	1996	1995	1994
Units awarded	—	32,297	77,376
Fair market value of units awarded	—	\$1.2	\$2.9
Shares granted related to units previously awarded	35,380	60,807	42,051
Fair market value of shares granted	\$1.3	\$2.2	\$1.6

The weighted-average grant date fair value of performance shares and performance based restricted shares granted in 1996, 1995 and 1994 was \$37.01, \$35.79 and \$37.19, respectively.

Restricted stock awards are currently granted under the Omnibus Plan only in connection with the hiring or retention of key executives and are subject to certain conditions. Restrictions are lifted generally three or four years after the date of grant, provided that the executive continues to be employed by the Company.

Following is a summary of restricted stock awards for the years ended December 31:

<i>Dollars in millions</i>	1996	1995	1994
Shares granted	52,042	112,773	55,050
Fair market value of shares granted	\$1.8	\$4.1	\$1.9
Shares canceled	58,680	11,452	1,535

The weighted-average grant date fair value of restricted stock granted in 1996, 1995 and 1994 was \$34.93, \$32.54 and \$34.97, respectively.

At December 31, 1996, there were 3,072,183 shares available for grant under the Omnibus Plan and 150,078 shares available for grant under the 1996 Directors Plan.

Compensation cost recognized in net earnings under the Company's stock-based compensation plans amounted to \$14 million in 1996, \$3.1 million in 1995 and \$1.4 million in 1994. Had compensation cost for the Company's 1996 and 1995 grants under its stock-based compensation plans been determined consistent with SFAS No. 123, the Company's net earnings and net earnings per common share for 1996 and 1995 would approximate the pro forma amounts shown below:

<i>In millions, except per share amounts</i>	1996	1995
Net earnings (loss):		
As reported	\$75.4	\$(657.1)
Pro forma	69.8	(662.2)
Net earnings (loss) per common share:		
As reported	\$.57	\$ (6.41)
Pro forma	.52	(6.46)

The weighted-average grant date fair value of options granted during 1996 and 1995 was \$10.07 and \$8.01 per option, respectively. The fair value of each option grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions for 1996 and 1995: a dividend yield of 1.07%; an expected volatility of 20.51%, a risk free interest rate of 7.0% and an expected life of 5.0 years and 4.1 years, respectively. The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to 1995.

15 Capital Structure

On November 20, 1996, the Company changed its state of incorporation from New York to Delaware. The Certificate of Incorporation of CVS provides for the authorization of 350,120,619 shares of capital stock of which 300,000,000 shares are common stock, \$.01 par value per share, 120,619 are cumulative preferred stock, \$.01 par value per share and 50,000,000 shares are preference stock, \$1.00 par value per share.

In connection with managing the Company's stock incentive plans, 842,900 shares of common stock were reacquired in 1995 at a cost of \$26.3 million. No shares were reacquired in 1996.

16 Redeemable Preferred Stock

At December 31, 1995, 17,269 shares of cumulative preferred stock, Series B, \$4.00 dividend, redeemable at \$100 plus accrued dividends were issued and outstanding. During 1996, the Company redeemed these shares at a cost of \$1.3 million plus accrued dividends.

17 Postretirement Benefits

The Company provides postretirement health benefits for retirees who meet certain eligibility requirements.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation (the "APBO") was 7.5% and 6.9% at December 31, 1996 and 1995, respectively.

Following is a summary of the accrued postretirement benefit cost at December 31:

In millions	1996	1995
Retirees	\$3.8	\$16.6
Fully eligible active plan participants	.1	1.4
Other active plan participants	.1	10.8
APBO	4.0	28.8
Unrecognized prior service gain	1.2	13.1
Unrecognized net gain	1.7	8.0
Accrued postretirement benefit cost	\$6.9	\$49.9

In 1992, the Company amended these plans to terminate certain benefits. The amendment resulted in a prior service gain of \$16.7 million. The prior service gain is being amortized over 13 years. The decrease in the accrued postretirement benefit cost from December 31, 1995 to December 31, 1996 is primarily due to the Footstar Distribution.

Following is a summary of the net periodic cost recorded for the years ended December 31:

In millions	1996	1995	1994
Interest expense	\$1.6	\$2.0	\$2.0
Service cost ⁽¹⁾	(.7)	(.9)	(.5)
	\$.9	\$1.1	\$1.5

⁽¹⁾ Net of prior service gain amortization.

For measurement purposes, a 9.3% increase in the cost of covered healthcare benefits was assumed for 1996. The rate was assumed to decline gradually to 5% in 2005, and remain level thereafter. A one percent increase in the healthcare cost trend would increase the APBO by \$.3 million at December 31, 1996 and the annual expense for 1996 by \$.03 million.

18 Employee Stock Ownership Plan

The Company sponsors a defined contribution plan for full-time employees which includes its Employee Stock Ownership Plan (the "ESOP").

In 1989, the ESOP Trust borrowed \$35.75 million through a 20-year loan that is guaranteed by the Company. The proceeds from the loan were used to purchase 6,688,494 shares of ESOP convertible preference stock from the Company. The original liquidation value of the ESOP convertible preference stock (\$5345) is guaranteed by the Company. Each share of ESOP convertible preference stock is convertible into 1.157 shares of common stock. The total number of new shares to be allocated each year is calculated by multiplying (i) the ratio of each year's debt service payment to total current and future debt service payments by (ii) the number of unallocated shares of ESOP preference stock in the plan. At December 31, 1996, 5.6 million shares were outstanding, of which, 1.2 million shares were allocated to participants, 4 million shares were committed to be released and the remaining 4.0 million shares were held in the ESOP Trust for future allocations. At December 31, 1996, the fair value of the allocated shares was approximately \$64 million. The Company is required to repurchase at the original liquidation value, for cash or common stock at the Company's option, the ESOP convertible preference stock allocated to participants upon distribution to the participant. Dividends are cumulative at the stated rate or the common rate if higher.

Following is a summary of the ESOP for the years ended December 31:

<i>In millions</i>	1996	1995	1994
Dividends paid	\$21.8	\$49.2	\$ —
Dividends accrued	—	—	24.9
Annual dividends	21.8	24.3	24.9
Tax benefit of annual dividends	8.8	9.8	10.0
Cash contributions	19.3	14.2	11.1
Interest costs incurred by the ESOP Trust	27.5	28.4	29.0
Compensation expense recognized ⁽¹⁾	3.4	6.2	5.9
Interest expense recognized ⁽¹⁾	12.0	6.4	5.3

⁽¹⁾ Amounts include discontinued operations.

The Company's contribution to the ESOP, plus the dividends paid on the ESOP convertible preference stock held by the ESOP Trust, are used to repay the loan principal and interest. The Company has reflected the guaranteed ESOP obligation as long-term debt on the consolidated balance sheets. The ESOP obligation is collateralized by the unallocated shares of ESOP convertible preference stock. A corresponding amount of "Guaranteed ESOP obligation" is recorded as a reduction of shareholders' equity. The ESOP convertible preference stock is not considered when computing primary earnings per share, but is considered when computing fully diluted earnings per share. In connection with the Company's strategic restructuring program, approximately 300,000 shares of ESOP convertible preference stock will be converted to common stock in 1997. Based on the market price of the Company's common stock at December 31, 1996, these conversions will result in an expense of \$3.5 million. This expense was provided for in the 1995 restructuring charge.

19 401(k) Profit Sharing Plan

The Company has a qualified 401(k) Profit Sharing Plan available to full-time employees who meet the plan's eligibility requirements. This plan, which is also a defined contribution plan, contains a profit sharing component that makes tax deferred contributions to each employee based on certain performance criteria. The plan permits employees to make contributions up to the maximum limits allowed by Internal Revenue Code Section 401(k). Under the 401(k) component,

the Company matches a portion of the employee's contribution under a predetermined formula based on the employee's contribution level and years of vesting service. Company contributions to the plan for both profit sharing and matching employee contributions totaled \$22.4 million, \$21.7 million and \$18.0 million in 1996, 1995 and 1994, respectively. These amounts include contributions made on behalf of employees of the Company's former divisions.

20 Income Taxes

Deferred income taxes reflect the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Following is a summary of the significant components of the Company's deferred tax assets and liabilities as of December 31:

<i>In millions</i>	1996	1995
Deferred tax assets:		
Property and equipment	\$ 57.5	\$112.5
Employee benefits	57.6	75.9
Inventories	6.9	22.7
Other assets	12.2	7.8
Total deferred tax assets	134.2	218.9
Deferred tax liabilities	—	—
Net deferred tax assets	\$134.2	\$218.9

Based on historical pre-tax earnings, the Company believes it is more likely than not that the deferred tax assets will be realized.

The Company's income tax (provision) benefit for continuing operations for the years ended December 31 consisted of the following:

<i>In millions</i>	1996	1995	1994
Federal	\$(129.6)	\$14.6	\$(47.7)
State	(34.2)	3.8	(15.0)
	\$(163.8)	\$18.4	\$(62.7)

The income tax (provision) benefit includes a net deferred tax benefit of \$.2 million and \$123.9 million in 1996 and 1995, respectively and a net deferred tax charge of \$15.3 million in 1994.

Following is a reconciliation of the Company's effective tax rate to the U.S. statutory income tax rates for the years ended December 31:

	1996	1995	1994
Percent of pre-tax income	40.6%	41.0%	41.0%
State income taxes, net of Federal tax benefit	(5.5)	(5.9)	(6.4)
Goodwill and other	(.1)	(.1)	.4
Statutory income tax rate	35.0%	35.0%	35.0%

As discussed in Note 2, the Company completed the Footstar Distribution on October 12, 1996. The Company believes that the Footstar Distribution should be tax-free to the Company and its shareholders, based on a legal opinion provided by outside counsel. However, since opinions of counsel are not binding on the Internal Revenue Service or the courts, it could ultimately be determined that the Footstar Distribution does not qualify as a tax-free distribution. If such occurred, the Company would be required to recognize a capital gain for tax purposes equal to the difference between the fair market value of the shares of Footstar stock distributed and the Company's basis in such shares. The Company, however, believes the likelihood of the Footstar Distribution not qualifying as a tax-free distribution to be remote.

21 Supplemental Cash Flow Information

During the years ended December 31, the Company had the following non-cash financing activities:

In millions	1996	1995	1994
Fair value of assets acquired	\$ —	\$ 4.8	\$41.8
Cash paid	—	4.8	36.6
Liabilities assumed	\$ —	\$ —	\$ 5.2
Stock or notes received for divisions sold	\$172.4	\$175.0	\$ —

Cash payments for income taxes and interest for the years ended December 31 were as follows:

In millions	1996	1995	1994
Income tax refund (payment)	\$ 3.8	\$(141.5)	\$(122.4)
Interest, net of amounts capitalized	\$31.5	\$ 55.5	\$ 34.1

22 Subsequent Event (Unaudited)

On February 6, 1997, the Company signed a definitive merger agreement to acquire Revco D.S., Inc. ("Revco") in a stock-for-stock merger valued at approximately \$2.8 billion. CVS will also assume approximately \$900 million of existing Revco debt as part of this transaction.

Under the terms of the merger agreement, CVS will combine with Revco in an exchange of stock that is expected to qualify for treatment as a pooling of interests transaction, tax free to Revco shareholders. If the merger is completed, for each share of Revco common stock held, Revco shareholders will receive the sum of (i) 0.4692 shares of CVS common stock and (ii) the number of shares of CVS common stock equal to the quotient obtained by dividing \$20 by the average closing price of CVS common stock during ten trading days randomly selected out of the twenty trading days ending on the fifth trading day preceding the closing date (collectively, the "Exchange Ratio"), provided that, under no circumstances will the Exchange Ratio exceed 1.0097 or be less than 0.8837.

The transaction is subject to approval by the shareholders of both companies, expiration of the applicable waiting period under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended, and certain other customary closing conditions. If all the closing conditions have been met, it is expected that the transaction will be completed by mid-year 1997.

23 Summary of Quarterly Results

Unaudited; in millions, except per share amounts	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales:				
1996	\$1,258.4	\$1,363.5	\$1,356.3	\$1,549.9
1995	1,128.1	1,202.9	1,170.0	1,364.0
Gross margin:				
1996	\$ 362.0	\$ 388.5	\$ 374.1	\$ 425.4
1995	322.3	342.8	330.4	363.1
Earnings (loss) from continuing operations:				
1996	\$ 40.6	\$ 90.9	\$ 44.8	\$ 63.3
1995	28.0	33.3	12.8	(100.6)
Net earnings (loss):				
1996	\$ 14.2	\$ (62.5)	\$ 63.6	\$ 60.1
1995	(26.4)	30.6	(5.2)	(656.1)
Earnings (loss) per common share from continuing operations:				
1996 Primary	\$.35	\$.83	\$.39	\$.55
1996 Fully diluted	.35	.83	.38	.55
1995	.23	.28	.08	(1.00)
Net earnings (loss) per common share:				
1996 Primary	\$.10	\$ (.62)	\$.57	\$.53
1996 Fully diluted	.10	(.62)	.55	.53
1995	(.29)	.25	(.09)	(6.28)

24 Market Information

CVS Corporation's common stock is listed on the New York Stock Exchange. Its trading symbol is CVS. Information with respect to quarterly trading ranges (based on low/high sales prices), dividends paid per share and the number of record shareholders is summarized as follows:

Unaudited	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
Market price per share ⁽¹⁾ :					
1996	\$27 ¹ / ₄ - \$36 ³ / ₈	\$35 ¹ / ₄ - \$44 ¹ / ₂	\$36 ⁵ / ₈ - \$46	\$36 ³ / ₈ - \$44 ³ / ₄	\$27 ¹ / ₄ - \$46
1995	30 ⁵ / ₈ - 37 ¹ / ₂	33 ³ / ₈ - 39 ⁷ / ₈	32 ³ / ₄ - 37 ¹ / ₄	28 ⁵ / ₈ - 37 ¹ / ₈	28 ⁵ / ₈ - 39 ⁷ / ₈
Dividends paid per share:					
1996	\$.11	\$.11	\$.11	\$.11	\$.44
1995	.38	.38	.38	.38	1.52
Number of common shareholders:					
1996					5,700
1995					6,500

⁽¹⁾ The stock prices shown in the table above are actual trading prices and do not reflect any adjustment for the effect of the Footstar Distribution which was completed on October 12, 1996.

Five-Year Financial Summary

CVS Corporation

<i>Dollars in millions, except per share amounts</i>	1996	1995	1994	1993	1992
Results of operations:					
Net sales	\$5,528.1	\$4,865.0	\$4,330.1	\$3,948.2	\$3,632.1
Operating profit ⁽¹⁾⁽²⁾	299.6	223.6	183.8	177.1	193.8
Earnings (loss) from continuing operations	239.6	(26.5)	90.3	91.9	65.7
Comparable earnings from continuing operations ⁽¹⁾⁽²⁾⁽³⁾	167.5	100.3	90.3	91.9	100.8
Net earnings (loss)	75.4	(657.1)	307.5	331.8	133.4
Net earnings (loss) available to common shareholders	60.9	(674.1)	290.5	75.1	85.1
Dividends declared	68.6	184.3	185.4	184.9	180.3
Per common share:					
Earnings (loss) from continuing operations	\$ 2.12	\$ (41)	\$.70	\$.71	\$.48
Comparable earnings from continuing operations ⁽¹⁾⁽²⁾⁽³⁾	1.44	.79	.70	.71	.81
Net earnings (loss)	.57	(6.41)	2.75	3.00	1.13
Dividends	.44	1.52	1.52	1.52	1.48
Financial Position:					
Current assets	\$1,972.7	\$2,560.0	\$2,650.5	\$2,384.0	\$2,429.8
Total assets	2,831.8	3,961.6	4,735.5	4,258.0	4,202.2
Current liabilities	1,181.9	1,797.7	1,642.7	1,292.7	1,350.5
Total long-term obligations and redeemable preferred stock	305.6	336.0	351.8	365.9	376.4
Percentage of net sales:					
Operating profit ⁽¹⁾⁽²⁾	5.4%	4.6%	4.2%	4.5%	5.3%
Comparable earnings from continuing operations ⁽¹⁾⁽²⁾⁽³⁾	3.0	2.1	2.1	2.3	2.8
Net earnings (loss)	1.4	(13.5)	7.1	8.4	3.7

⁽¹⁾ For comparative purposes, operating profit for 1995 excludes the effect of \$165.6 million of restructuring and asset impairment charges and \$494 million of non-recurring operating charges. Comparable earnings from continuing operations and comparable earnings per common share from continuing operations for 1995 excludes the after-tax effect of these charges.

⁽²⁾ For comparative purposes, operating profit for 1992 excludes the effect of \$594 million of restructuring charges. Comparable earnings from continuing operations and comparable earnings per common share from continuing operations for 1992 excludes the after-tax effect of this charge.

⁽³⁾ For comparative purposes, comparable earnings from continuing operations and comparable earnings per common share from continuing operations for 1996 excludes the after-tax effect of the \$1214 million gain on sale of securities.

Officers and Directors

Officers:

Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer
CVS Corporation

Thomas M. Ryan
Vice Chairman and Chief Operating Officer
CVS Corporation
President and Chief Executive Officer
CVS Pharmacy, Inc.

Charles C. Conaway
Executive Vice President and
Chief Financial Officer
CVS Corporation
Executive Vice President and
Chief Financial Officer
CVS Pharmacy, Inc.

Daniel C. Nelson
Vice President
CVS Corporation
Executive Vice President—Marketing
CVS Pharmacy, Inc.

Larry J. Merlo
Vice President
CVS Corporation
Senior Vice President—Stores
CVS Pharmacy, Inc.

Larry D. Solberg
Vice President
CVS Corporation
Senior Vice President—Controller
CVS Pharmacy, Inc.

Aldwin E. Jolly
Vice President
CVS Corporation
Senior Vice President—Human Resources
CVS Pharmacy, Inc.

Philip C. Galbo
Vice President—Treasurer
CVS Corporation
Vice President—Treasurer
CVS Pharmacy, Inc.

Nancy R. Christal
Vice President—Investor Relations
CVS Corporation

Zenon P. Lankowsky
Secretary
CVS Corporation
Vice President—General Counsel
CVS Pharmacy, Inc.

Directors:

Allan J. Bloostein⁽²⁾
President Allan J. Bloostein Associates,
a consulting firm

W. Don Cornwell⁽¹⁾
Chairman of the Board and
Chief Executive Officer
Granite Broadcasting Corporation

Thomas P. Gerrity⁽¹⁾
Dean of The Wharton School of the
University of Pennsylvania

Stanley P. Goldstein⁽³⁾
Chairman of the Board and
Chief Executive Officer
CVS Corporation

Michael H. Jordan⁽³⁾⁽⁴⁾
Chairman of the Board and
Chief Executive Officer
Westinghouse Electric Corporation

William H. Joyce⁽¹⁾
Chairman of the Board and
Chief Executive Officer
Union Carbide Corporation

Terry R. Lautenbach⁽²⁾⁽³⁾
Retired; formerly Senior Vice President
International Business Machines
Corporation

Terrence Murray⁽²⁾
Chairman, President and Chief Executive Officer
Fleet Financial Group

Harvey M. Rosenthal⁽⁴⁾
Retired; formerly President
Melville Corporation

Thomas M. Ryan
Vice Chairman and Chief Operating Officer
CVS Corporation
President and Chief Executive Officer
CVS Pharmacy, Inc.

Ivan G. Seidenberg⁽²⁾
Chairman of the Board and
Chief Executive Officer
NYNEX Corporation

Patricia Carry Stewart⁽¹⁾
Retired; formerly Vice President
The Edna McConnell Clark Foundation

M. Cabell Woodward, Jr.⁽²⁾⁽³⁾
Retired; formerly Vice Chairman,
Chief Financial Officer and a Director
ITT Corporation

⁽¹⁾ Member of the Audit Committee of the
Board of Directors.

⁽²⁾ Member of the Compensation Committee of
the Board of Directors.

⁽³⁾ Member of the Executive Committee of the
Board of Directors.

⁽⁴⁾ Retiring as of the 1997 Annual Shareholders' Meeting.

Shareholder Information

Corporate Headquarters
CVS Corporation
One CVS Drive
Woonsocket, RI 02895
(401)765-1500

Annual Shareholders' Meeting
10:00 a.m. on Tuesday, May 27, 1997
CVS Corporate Headquarters
One CVS Drive
Woonsocket, RI 02895

Stock Market Listing
New York Stock Exchange
Symbol: CVS

Shareholder Communications
Please address comments
or inquiries to:
Nancy R. Christal
Vice President, Investor Relations
CVS Corporation
670 White Plains Road - Suite 210
Scarsdale, NY 10583
(800) 201-0938

The Company's Annual Report to the Securities and Exchange Commission, on Form 10-K, may be obtained free of charge, upon request.

Dividend Payment Dates
Historically, CVS' dividend has been declared at the beginning of each quarter and paid on the first of the month following the declaration.

Internet Address
Major press releases and other information are available on CVS' Internet home page:
<http://www.cvs.com>

Transfer Agent and Registrar
Chase Mellon
Shareholders Services L.L.C.
P.O. Box 3315
South Hackensack, NJ 07606
(800) 851-9677

CVS
pharmacy

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PHARMACY**

CVS Corporation
One CVS Drive Woonsocket, RI 02895